CN

Canadian National
Annual Report 1981

In Business for Canada

The words on the cover constitute more than a listing of products and services. They are intended to evoke something of what CN means to Canadians; its diversity, its special place in history and in contemporary affairs.

La version française du présent rapport est disponible sur demande à l'adresse suivante:

Canadien National
Affaires publiques et publicité
B.P. 8100
Montréal (Québec)
H3C 3N4

System Highlights

	1981	1980	Increase (Decrease) Amount	Percent
Financial Results				
Revenues	$ 4,285.8	$ 3,705.6	$ 580.2	15.7
Interest expense – net	170.8	110.9	59.9	54.0
Net income	193.2	192.7	0.5	0.3
Dividend	38.6	38.5	0.1	0.3
Return on average investment %	7.8	6.9	0.9	13.0
Return on average equity %	6.4	6.8	(0.4)	(5.9)
Capital Expenditures				
Additions to properties	666.5	561.0	105.5	18.8
Assets and Working Capital				
Current assets	1,062.9	1,017.9	45.0	4.4
Working capital (Deficiency)	(8.1)	(27.4)	19.3	–
Properties	4,839.0	4,399.0	440.0	10.0
Total assets	6,140.2	5,645.2	495.0	8.8
Capital Structure				
Long-term debt (including current portion)	1,737.3	1,591.0	146.3	9.2
Equity	3,106.0	2,944.9	161.1	5.5
Debt ratio %	35.9	35.1	0.8	2.3
Employees				
Average number of employees	73,287	74,014	(727)	(1.0)
Average annual wage per employee	$25,906	$22,720	$ 3,186	14.0
Average annual cost per employee	30,967	27,163	3,804	14.0

Dollars throughout the report are expressed in millions except average annual wage and cost per employee and Consolidated Financial Statements.

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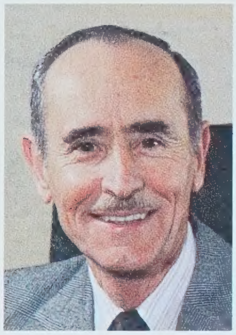
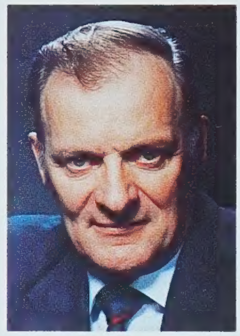
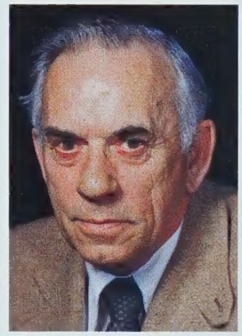
Directors









[2] J.A. Dextraze, C.C., C.B.E., C.M.M., D.S.O., C.D., LL.D.
Ottawa, Ont.
Chairman

[2] R.A. Bandeen, O.C., Ph.D., LL.D., D.C.L.
Montreal, Que.
President and Chief Executive Officer

Austin E. Hayes
Halifax, N.S.

[2] J.S. Hinds, Q.C.
Sudbury, Ont.

[1] The Hon. J.H. Horner, P.C.
Pollockville, Alta.

Benoit Joncas
Matane, Que.
since 10 April 1981

C. Kroft
Winnipeg, Man.

D.G.A. McLean
Vancouver, B.C.

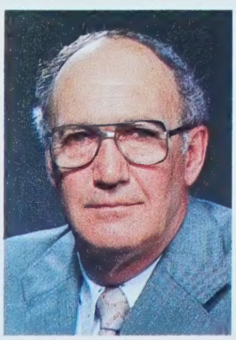
[1] Ewart A. Pratt
St. John's, Nfld.

[2] F.D. Rosebrugh
Toronto, Ont.

[1,2] W.J. Vancise, Q.C.
Regina, Sask.

[1] Member of the Audit Committee
[2] Member of the Compensation Committee

Pierre Des Marais II
Montreal, Quebec
until 9 April 1981



H.C. Pinder
Saskatoon, Sask.
until 16 July 1981

The Directors wish to acknowledge the excellent service rendered to the Company by two Board members whose terms of office ended in 1981: Messrs. Pierre Des Marais II and H.C. Pinder.

To the Honourable
The Minister of Transport
Ottawa

Mr. Minister:

The Board of Directors of Canadian National Railways is pleased to submit the Annual Report for 1981. The Report documents a year in which CN achieved a good financial result despite an abrupt mid-year change in the economy. A softening in demand for CN services began early in the third quarter and by year-end a recessionary environment was firmly in place.

The Report recognizes the unique challenge of this environment coincident with the urgent need to find a large amount of new capital to complete important major projects such as the expansion of Western rail capacity.

It is the view of the Board that CN is able to serve Canada best when it is in a position to act, and be held accountable, as a socially responsible business corporation. This means receiving full financial compensation for non-commercial services provided at the request of the Government or because of any statutory requirement. It is the hope of the Board that this principle will be recognized whenever we are required to provide an uneconomic service, and particularly in proceedings and negotiations designed to settle what is usually called the Crowsnest Pass rates issue. The progress made in this area in recent months is encouraging. We believe that an early resolution of the issue, incorporating the principles referred to above, is essential to ensuring the efficient movement of Canadian goods, including grain, to export markets.

Difficult economic conditions and a continuation of the problems brought about by inflation and recession are foreseen for the year ahead. The skills, experience and dedication of CN people everywhere has made our achievements to date possible. There is no reason to believe that this rich human resource will not continue to move CN with a positive result in the years ahead.

This will be my final report as Chairman of the Board. It is, therefore, also a time of some personal reflection.

There is a need today for all Canadians to put our work and other activities into the context of what is best for our country. Our loyalty has to be to Canada as a whole and to each other as Canadians.

Canadian National has historically acted as a great force for national unity and the Board of Directors believes that it should, and will, continue to fulfil that important role.

J.A. Dextraze
Chairman

Officers
as at December 31, 1981

J.A. Dextraze, C.C., C.B.E., C.M.M., D.S.O., C.D., LL.D.
Chairman of the Board

R.A. Bandeen, O.C., Ph.D., LL.D., D.C.L.
President and Chief Executive Officer

G.M. Cooper
Vice-President and Secretary

J. Gratwick
Vice-President, Executive

A.R. Williams
Corporate Vice-President
Western Canada

Corporate

J.M. LeClair
Senior Corporate Vice-President

L.L. Atkinson
Vice-President
Human Resources

G.C. Church
Treasurer

S.T. Cooke
Vice-President
Labour Relations

A.E. Deegan
Vice-President
Central Services

P.J. Foliot
Vice-President
Purchases and Materials Management

R.C. Franklin
Vice-President
Finance

E.D. Pinsonnault, Q.C.
Vice-President
Law

S.D.H. Thomas
Corporate Comptroller

Divisions

CN Rail

R.E. Lawless
President
CN Rail

D.W. Blair
Vice-President
Atlantic Region

J.L. Cann
Vice-President
Operations

R.J. Hansen
Vice-President
Prairie Region

Y.H. Masse
Vice-President
St. Lawrence Region

J.H.D. Sturgess
Vice-President
Marketing

R.A. Walker
Vice-President
Mountain Region

G.A. Van de Water
Vice-President
Great Lakes Region

CN Holdings

C.F. Armstrong
President
CN Holdings

D.C. Campbell
General Manager
CN Communications

P.A. Clarke
President and General Manager
TerraTransport

J.B. Griffith
General Manager
CNTL Trucking Subsidiaries

J.R. Lagacé
Vice-President
Real Estate

C. Perron
President and General Manager
CN Express

C.J. Sauvé
General Manager
CN Hotels and Tower

R.J. Tingley
President and General Manager
CN Marine Inc.

C.J. Hudson
General Manager
CNM Inc.

J.J. Prairie
General Manager
CN Exploration Inc.

Grand Trunk Corporation

J.H. Burdakin
President

CN Investment Division

T. Cedraschi
President and Chief Executive Officer

Canac Consultants Limited

W.H. Bailey
President and Chief Executive Officer

Companies included in the Consolidated Financial Statements of the Canadian National Railway System as at December 31, 1981

Consolidated Companies

Autoport Limited
Canac Consultants Limited
The Canada and Gulf Terminal Railway Company
Canadian National Express Company
Canadian National Hotels (Moncton) Ltd.
Canadian National Railway Company
The Canadian National Railways Securities Trust
Canadian National Steamship Company, Limited
Canadian National Telegraph Company
Canadian National Transfer Company Limited
Canadian National Transportation, Limited
The Canadian Northern Quebec Railway Company
Canat Limited
Canaven Limited
Central Vermont Railway, Inc.
Chalut Transport (1974) Inc.
Chapman Transport Limited
[2] CN Exploration Inc.
C.N. (France) S.A.
CN Marine Inc.
CNM Inc.
CN Tower Limited
CN Tower Restaurants Ltd.
CN Transactions Inc.
Coastal Transport Limited
Cronin Transport Limited
Detroit, Toledo and Ironton Railroad Company
Domestic Two Leasing Corporation
Domestic Three Leasing Corporation
Domestic Four Leasing Corporation
DTI Enterprises Inc.
Duluth, Winnipeg and Pacific Railway Company
Eastern Transport Limited
Empire Freightways Limited
Grand Trunk Corporation
Grand Trunk Land Development Corporation
Grand Trunk Radio Communications, Inc.
Grand Trunk Western Railroad Company
The Great North Western Telegraph Company of Canada
Hoar Transport Company Limited
Husband International Transport (Ontario) Limited
Husband Inc.
Midland Superior Express Limited
The Minnesota and Manitoba Railroad Company
The Minnesota and Ontario Bridge Company
Mount Royal Tunnel and Terminal Company, Limited
The Northern Consolidated Holding Company Limited
Northern Townsites Limited
NorthwesTel Inc.
Provincial Tankers Limited
The Quebec and Lake St. John Railway Company
Royal Transportation Limited
Swan River-The Pas Transfer Ltd.
Terra Nova Telecommunications Inc.
The Toronto-Peterborough Transport Company, Limited
Transport Husband (Québec) Inc.

Jointly-operated and Other Companies in which the System has Investments

The Belt Railway Company of Chicago
Canaprev Inc.
Chicago & Western Indiana Railroad Company
Compagnie de Gestion de Matane Inc.
Computer Sciences Canada, Ltd.
East Yard Development Ltd.
Eurocanadian Shipholdings Limited
Halifax Industries (Holdings) Limited
Halterm Limited
Intercast S.A.
[1] Lakespan Marine Inc.
[1] Les Entreprises Bussières Ltée
The Public Markets, Limited
Seabase Limited
Shawinigan Terminal Railway Company
Société du port ferroviaire de Baie Comeau-Hauterive
Telesat Canada
The Toronto Terminals Railway Company
Trailer Train Company

[1] Acquired in 1981
[2] Activated in 1981

In addition, the property of the Canadian Government Railways is entrusted to the Canadian National Railway Company as part of the System.

The managerial and operational skills of Canadian National were severely tested during 1981 – a year characterized by continuing high operating costs and a revenue-draining recession which began in mid-year and has continued into the early months of 1982.

CN came through, however, with a good performance as reflected in the continued provision of efficient transportation and other services, in the expansion of physical capacity to meet future needs and in an improved financial result.

As in the past several years, payments were received in 1981 for services provided to the Federal Government and VIA Rail Canada for prior years. These payments did not, however, materially lessen the challenge to management to maintain a profit position in the face of difficult business conditions, particularly during the second half of the year.

A successful response to the challenge is evident in the bottom line of the Consolidated Statement of Income (Page 31) which shows a net profit for the year of $193.2 million. This result is slightly better than that of the previous year. It enabled the Company to pay a dividend of $38.6 million to the Federal Government compared with $38.5 million in 1980. It represents a return on average investment of 7.8% compared with 6.9% the previous year.

The inflationary/recessionary pattern of 1981 bore particularly hard on CN Rail – the division which produces by far the largest part of corporate income. The mid-year recession brought about lower demand for transportation of important categories of bulk freight. Production declines because of labour difficulties in key industrial sectors also cut into traffic and revenues. However, selective rate increases, marketing programs and careful management of expenses countered the adverse factors to a significant degree. The end result for CN Rail was a profit of $230.4 million – down by $20 million from the previous year but representing a good performance under the circumstances.

The Grand Trunk Corporation, which controls CN-owned properties in the United States, had a relatively good year, largely because of tight control of expenses and appropriate use of new U.S. tax and freight rate legislation.

CN Holdings – the Division responsible for CN Communications, CN Hotels & Tower, CN Express, most of the other non-rail activities of the Corporation and surface transport in Newfoundland – also responded well to the management challenges of 1981. The "turn around" represented by the decrease in CN Express losses, as well as the positive approach to the operating and financial problems of TerraTransport, merit special attention.

Continuing the corporate reorganization process, a number of headquarters functions were grouped under the Senior Corporate Vice-President. The objective is to better the focus of leadership and coordination in the planning and direction of the company, as well as to provide an appropriate range of managerial, technical, professional and administrative support services to the divisions.

To meet its capital needs in 1981, CN had to arrange a significant amount of financing from external sources. The management of this process was both innovative and effective.

Through careful evaluation of world capital markets we were able to borrow at very advantageous rates. Hedging of some of our bond issues brought further advantages. A significant innovation was a Company-wide electronic cash management system which enables important savings to be made in our banking and interest costs. This system was introduced after study of competitive proposals from the major banking institutions.

More detailed comment on the performance of the various divisions and sectors of Canadian National may be found elsewhere in this Annual Report. It seems important to stress here, however, that losses on CN Express, TerraTransport and the Montreal commuter service, together with the continuing requirement to carry grain at statutory (Crowsnest) rates well below cost, continue to distort the financial results of the Corporation and mask much of what it achieves in the national interest. Losses in the above areas amounted to $331.9 million in 1981; an increase of 10% over 1980.

Capital expenditures in 1981 reflected expansion and improvement of plant and equipment in response to long-term market demand, particularly for bulk freight transportation. Expenditures on additions to property amounted to $666.5 million in 1981, an increase of $105.5 million over the previous year. More than 80% of the capital expenditure was for the improvement and expansion of railway properties.

About half of the 1981 capital expenditure program was financed from internally-generated funds and the rest from commercial borrowings. This was appropriate financing in line with the current debt-equity structure. Looking to the future, however – and looking particularly at the need for expansion of rail capacity in Western Canada – there is obvious need for much more capital than can be generated internally or borrowed prudently. Capital requirements over the next decade are estimated at $14 billion, including $3 billion for rail plant expansion in Western Canada.

Settlement of the Crowsnest rates issue in a manner which would provide CN with full commercial compensation for the movement of Western grain to export positions would enable the Company to provide a greater part of its future capital needs from its own resources. Such a settlement would also enable CN to apply the most up-to-date transportation technology and distribution techniques to the movement of grain as well as to such other commodities as coal, potash, forest products, petrochemicals and manufactured products. It would also go far towards lessening the possibility

of future rationing of rail transportation in Western Canada, either by price or by limitation of volume.

Difficult times lie ahead for Canadian National, as for most Canadian business enterprises. The severe economic conditions which marked the second half of 1981 are likely to continue into the first half of 1982. This means that the combined effect of economic slowdown and the high cost of doing business will challenge the skill, experience and dedication of everyone who works for the Corporation. I am sure that once again a good response to the challenge will be forthcoming and that Canadian National will continue the positive contribution to Canada which the profit position of recent years has enabled it to make.

My resignation as President and Chief Executive Officer of Canadian National will take effect as this Annual Report is being released. The decision to leave was not an easy one. But it was made less difficult by the knowledge that the future of the System is in the hands of a good management team backed by a skilled and experienced staff. Working together we have given new shape and new directions to Canadian National and it has been a privilege for me to share in that experience.

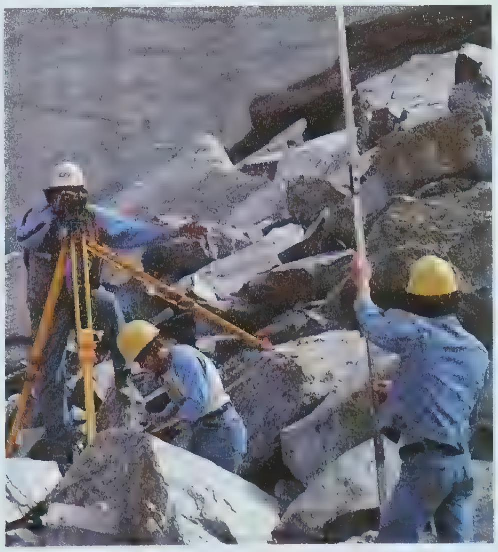
I take up new challenges confident in the belief that CN, and Canada, will continue to be well served by able and dedicated men and women of the CN family.

R.A. Bandeen
President & Chief Executive Officer

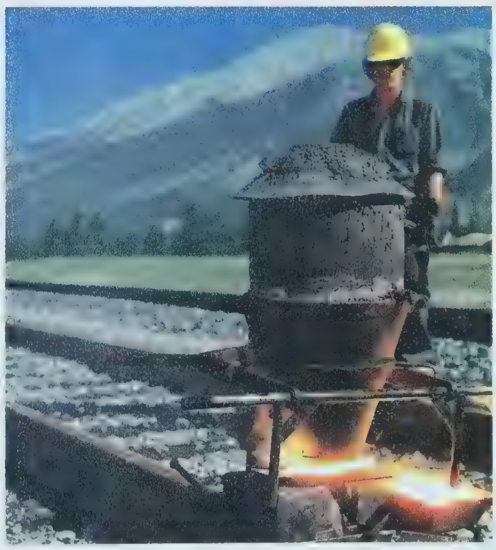
Five year financial and statistical summary

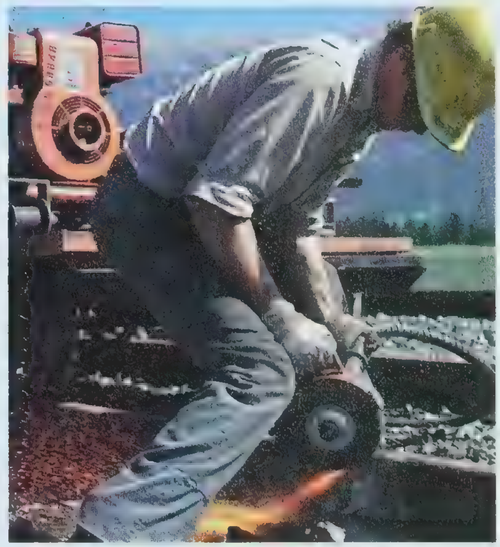
		1981	1980	1979	1978	1977
Operations	Revenues	$ 4,285.8	$ 3,705.6	$ 3,381.6	$ 2,965.8	$ 2,694.5
	Operating income	351.5	272.0	283.0	213.7	176.3
	Interest expense – net	170.8	110.9	96.4	95.2	154.8
	Net income	193.2	192.7	208.2	136.1	28.0
	Dividend	38.6	38.5	41.6	27.2	–
	Return on average investment %	7.8	6.9	7.5	6.0	4.8
Capital Expenditures	Additions to properties	666.5	561.0	558.3	375.0	372.7
Assets and Working Capital	Current assets	1,062.9	1,017.9	870.0	726.1	690.9
	Working Capital (Deficiency)	(8.1)	(27.4)	176.5	157.4	101.4
	Properties	4,839.0	4,399.0	3,971.2	3,628.3	3,498.3
	Total assets	6,140.2	5,645.2	5,143.1	4,531.1	4,675.7
Capital Structure	Long-term debt (including current portion)	1,737.3	1,591.0	1,522.5	1,336.5	1,586.3
	Equity	3,106.0	2,944.9	2,764.0	2,493.1	2,384.3
	Debt ratio %	35.9	35.1	35.5	34.9	40.0
Traffic	Revenue ton miles freight (billions)	86.4	88.0	84.6	79.2	74.5
	Express shipments handled (millions)	3.5	6.9	8.9	8.5	7.5
Employees	Average number for year	73,287	74,014	76,592	78,247	78,671
	Average annual wage per employee	$25,906	$22,720	$20,589	$18,260	$16,958

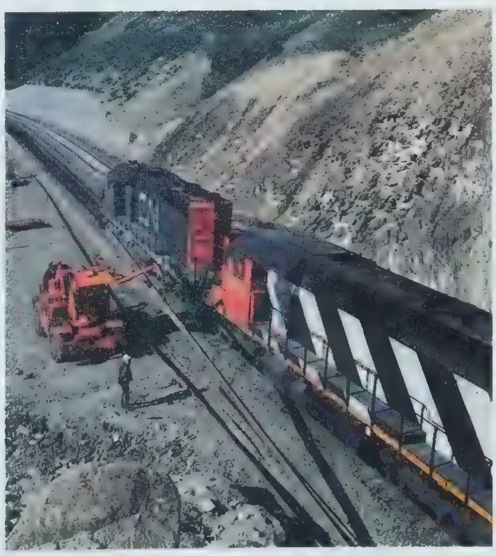
Work is well in progress on CN's Plant Expansion Program designed to provide double track capacity in Western Canada and through the Rockies to the Pacific Coast. The pictures on these and the following pages show work on sections of the line in Alberta and British Columbia, where traffic congestion is starting to be felt. The pictures on these two pages illustrate the initial **Grading and Bridging** steps of the program. Blasting (left) clears ground for the grading of a parallel right of way and the twinning of bridges.



Track Laying follows Grading and Bridging. Illustrated left and below is the use of modern machinery to lay and field-weld quarter-mile lengths of steel rail so as to form a continuous, smooth, long-lasting section of track. The work is planned so that great unit trains can run through work sites with a minimum of delay








CN
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Track in place is not ready for regular train traffic until the ballast has been tamped firmly into place and the track levelled and aligned. These are exacting tasks employing advanced technology and requiring good engineering judgment. Signalling, which includes installation and wiring of electrically-controlled track switches, completes the process. All pictures were taken during work on the Edson, Albreda and Tete Jaune subdivisions of CN Rail in Alberta and British Columbia.

CN Rail earned a profit of $230.4 million in 1981 compared with $251.0 million in 1980. Lower 1981 earnings resulted from the sharp deterioration in the Canadian economy which occurred in the second half of the year and brought about downturns in traffic and revenues from important market segments including forest products, fuels and chemicals, and automotive. Major industrial strikes, notably in British Columbia forest products and in coal and steel, were significant factors in the second half revenue fall-off. However, rate increases,careful control of expenses, service modifications and marketing initiatives enabled the Division to counter the adverse economic environment to a significant degree and to achieve approximately the profit level of recent years. The effect of increased payments for prior year's services was largely offset by increased losses from carrying grain at fixed statutory rates.

Marketing Innovations

A key service innovation introduced during 1981 was the "Destinations Train". Trains made up at Montreal and Toronto for certain Western Canadian cities are "run-through" without marshalling at intermediate terminals. This is a service-sensitive and fuel-efficient concept, enabling CN Rail to move east-west traffic more efficiently with a resulting improvement in its share of a number of important markets.

The trend towards utilization of distribution centres continued in 1981 and there was a very large increase (about 500%) in the amount of lumber from Western Canada moving through distribution yards in southern Ontario, southern Quebec and New England. Development of such centres, plus changes in the pricing approach, allowed CN Rail to move "green" lumber from British Columbia to the U.S. East Coast for the first time. This product has historically moved exclusively by ship.

"Tri-Paks" – a new piggyback service allowing for the movement of three 45-foot trailers on three articulated flatcars – was introduced during the year. CN also successfully experimented with an intermodal unit for livestock transport.

A very important event of the year was the signing by mining companies and Japanese coal buyers of contracts for the movement of about 9.4 million tons per year of coal from the Peace River fields of Northeastern B.C., beginning in late 1983 or early 1984. This will represent the largest amount of traffic ever to be contracted for by CN Rail. Another large contract signed in 1981 covers movement of 440,000 tons per year of corn from Michigan and Ohio to Maine over the GTW – CN System.

While 1982 will be a difficult economic year, CN Rail intends to continue and accelerate new and different marketing programs and projects. For instance, plans will be made for a permanent potash transshipment facility at Thunder Bay, now that the viability of the rail-water network to Great Lakes area points has been established. In addition, the potash unit train system to the U.S. – operated in conjunction with the Potash Corporation of Saskatchewan – will be expanded. Planning for a 1984 start-up of a petrochemical tank farm at Prince Rupert will go forward in 1982.

A major effort will be made to re-establish a high-volume piggyback service between Montreal and Toronto in 1982. This project would utilize existing CN capacity more efficiently and lessen the need for expansion of highway capacity.

Operating Performance

During 1981, Operations continued to improve productivity in the vital area of fuel, mainly through concerted fuel-saving programs and increased use of lower-cost synthetic fuel.

Other operating benefits were realized through improvements in trainload, which averaged 3.6% more gross tons per train than in the previous year.

The overall integrity and dependability of the basic rail plant continued to improve because of the track and roadway plant expenditures detailed below under Capital Investment. In this context, 269 diesel units and 5,152 freight cars were main-shopped for major sheduled repairs in 1981.

More than 15 miles of double track was put into service in Western Canada, with a further 12.3 miles in the final stages of completion. Approximately 100 miles of new major roadbed construction was also a significant part of the plant expansion program in the West.

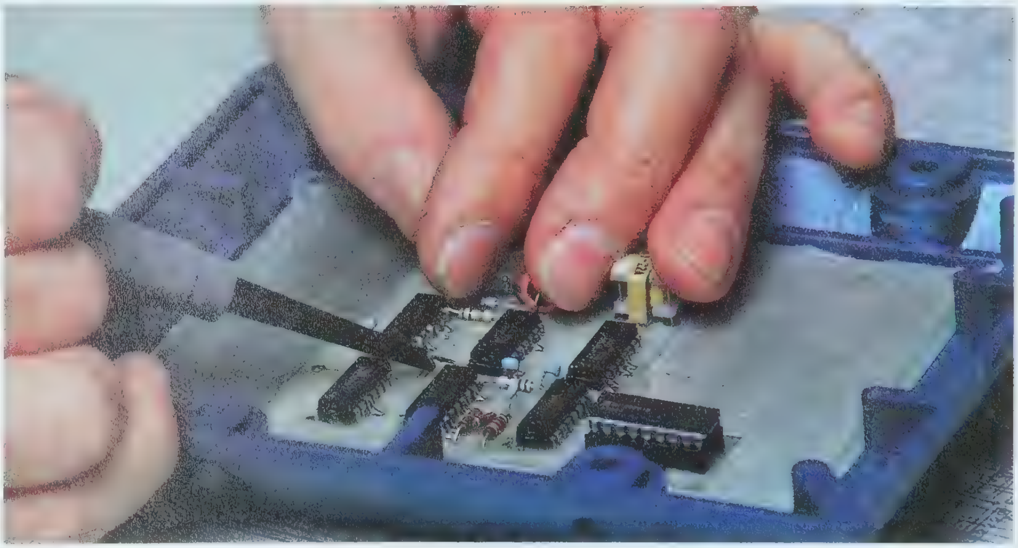
Capital Investment

Capital investment of $511.1 million was made in 1981, of which $224.3 was for renewal and improvement of the basic track and roadway plant. The multi-year Plant Expansion Program to increase track capacity in Western Canada required capital spending of $100.1 million.

It is planned to increase expansion capital significantly in 1982. New investment will be made in the territory from Winnipeg to Vancouver, and also on the British Columbia northern line to Prince Rupert. The latter investment will enable CN Rail to handle the major new coal movements originating in northeast British Columbia in the latter part of 1983 or early in 1984.

In 1981, 526.9 miles of new rail were laid and 2.2 million track ties installed, of which 310,000 were of concrete. Plans for 1982 involve 443 miles of new rail and 1,718,000 track ties (1,413,000 of wood and 305,000 of concrete). Delivery will be taken of 20 new 3000-horsepower diesel locomotives at a cost of $21.5 million. The complete rebuilding of twenty existing locomotives will be undertaken in 1982 at CN Rail main shops. This project will not only provide virtually new locomotives but will also assist in sustaining employment levels. Freight car construction, rebuilds and modifications will also be carried out.

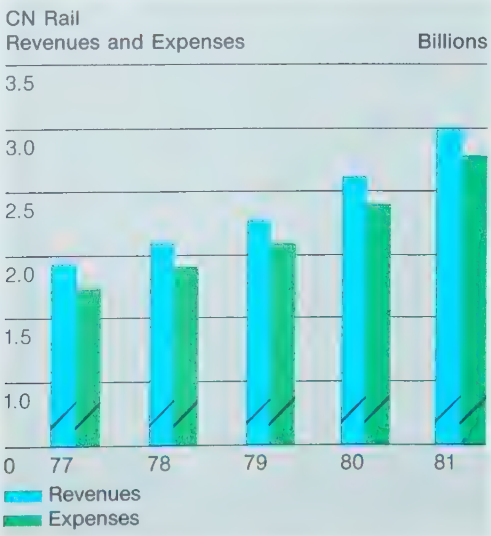
REIS, Railway Electronic Identification System, is a CN Rail project in the advanced development stage. It consists of a small transponder applied to each car and locomotive. When activated from trackside, the transponder will transmit information about the equipment directly into CN Rail's computer system.



1982 Business Outlook

It is expected that the sharp business recession which started in Canada in 1981 will exercise a strong influence on 1982 financial results. Traffic volumes in virtually all market segments will be low until an increase occurs in industrial and consumer demand, both of which are severely affected by the continuance of high interest rates. Other negative influences on operating income are expected to be the reduction by VIA Rail Canada Inc. of approximately twenty per cent of passenger train miles compared with 1981; significant 1981 non-recurring credits involving prior years' subsidy payments and cost recoveries; and Canadian Transport Commission capital/operating expense definition changes effective in 1982.

Recent Federal Government announcements regarding statutory Crowsnest grain rates have brightened the prospects for an end to the long-standing erosion of railway earnings caused by this rate. According to a recently-issued report prepared for the Grain Transportation Directorate of Transport Canada, the gap between costs and grain revenue at the statutory rate, plus the subsidy for grain-dependent branch lines, will approach $300.0 million for CN Rail in 1982. Resolution of the Crow rate issue would stop this drain on the financial resources of CN Rail and would assist in the provision of the capital needed to expand capacity in pace with the expected growth of rail traffic in Western Canada.



Grand Trunk Corporation

The railways included in the Grand Trunk Corporation (GTC) provide rail transportation services principally in Michigan, Ohio, Indiana and Illinois – through the Grand Trunk Western Railroad (GTW) and its wholly-owned subsidiary the Detroit, Toledo and Ironton Railroad Company (DTI), Minnesota – Duluth, Winnipeg and Pacific Railway Company (DWP), and Vermont – Central Vermont Railway Inc (CV).

The Grand Trunk Corporation had a good year despite inflation and recession. Income was $40.5 million (Canadian) compared with $9.1 million in 1980. The improvement was realized by:

- Planned cost reductions and volume related savings.

- Synergy benefits obtained through the acquisition by the Grand Trunk Western Railroad Co. of the Detroit, Toledo and Ironton Railroad Company and The Detroit and Toledo Shore Line Railroad Company. The GTW acquired full ownership of DTSL in April 1981 and merged DTSL with GTW October 1, 1981. The year marked the first full year of ownership by the GTW of the DTI.

- Proceeds of $5.4 million (U.S.) from the sale of accelerated cost recovery deductions and investment tax credits as provided by the U.S. Economic Recovery Tax Act of 1981. This important piece of legislation allows the sale of tax attributes from an owner to a second party.

- The process of "deregulation" which is allowing U.S. railways to meet higher costs through freight rate increases.

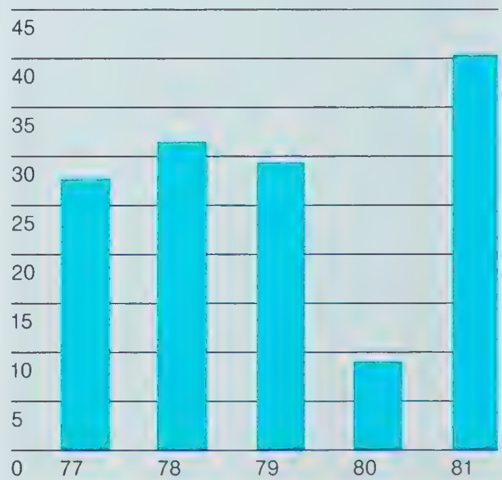
Outlook

The economic outlook for 1982 is a cause of concern to the Grand Trunk Corporation – concern which is intensified by the current recession. Projections for automobiles, steel, coal, machinery, chemicals and forest products are less than anticipated, causing corresponding reductions in previous carloading forecasts.

On the positive side, however, many economists believe that some recovery from the current recession in the U.S. will begin about mid-year. In addition, as noted previously, the Economic Recovery Tax Act enhances the ability of U.S. railroads to meet their capital needs during the 1980's while the continuing process of "deregulation" (largely through the Staggers Rail Act of 1980) is expected to enable all the railways owned by the Grand Trunk Corporation to recover a higher proportion of cost increases.

In order to deal effectively with the difficult economic conditions which are expected to prevail during 1982, to take advantage of the positive aspects and to respond to potential traffic losses, GTC has developed contingency plans which include cutbacks in operating expenses and capital expenditures as well as continued improvements in productivity.

Grand Trunk Corporation Income — Millions of Dollars



CN Communications

CN Communications had a busy and, on the whole, a successful year in 1981. Despite the economic recession of the latter part of 1981, the Division was able to increase its volume of business over the previous year and earn higher revenues. Net income, at $31.8 million, was not greatly below the 1980 figure of $33.2 million.

During the year the name of the Division was changed from "CN Telecommunications" to "CN Communications". The purpose was to reduce confusion with a major component of the Division, CNCP Telecommunications.

An important decision taken in 1981 was to proceed, in equal partnership with Canadian Pacific Limited, with the establishment of a new enterprise to provide telephone terminal equipment to business and industry for interconnection to the public telephone network. The new organization, to be known as Telecommunications Terminal Systems (TTS), will be launched in the first quarter of 1982 and will enable the partnership to compete in a new and growing Canadian market for telephone terminal equipment.

CNCP Telecommunications

CNCP Telecommunications which markets a full range of telecommunications services across Canada in competition with members of the TransCanada Telephone System, had a good year operationally. Financial results, however, showed the effect of factors essentially beyond management control including higher interest charges and depreciation. The Company filed for a general rate increase during the year and was awarded increases which became effective January 1, 1982.

NorthwesTel

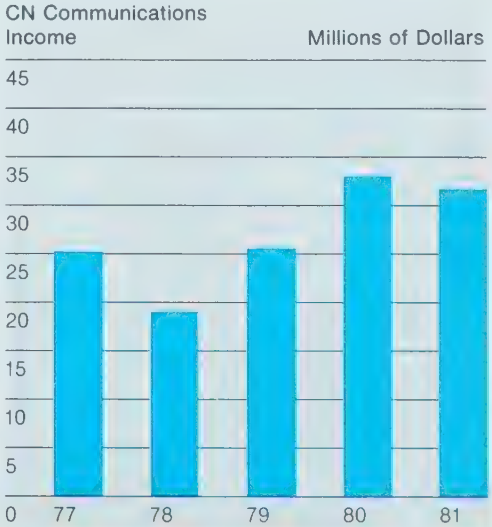
NorthwesTel is a wholly owned subsidiary of CN Communications with operating headquarters at Whitehorse. The company provides telephone service and a full range of modern telecommunications services in Canada's northwest, including northern British Columbia, the Yukon and the western portion of the Northwest Territories.

NorthwesTel had a good year in 1981. Income increased by 11.1% and revenues were up by 14.4% while improved productivity held operating expenses to an increase of 12.2%. Some rate increases were approved by the CRTC in 1981 and the company has filed applications for further rate increases in 1983. A major long-term contract was signed with the U.S. telecommunications firm Alascom Inc. in 1981. This will help ensure a stable revenue base for NorthwesTel from the lease of communications facilities linking Alaska to the lower 48 of the United States.

Terra Nova Telecommunications

From headquarters at Gander, Terra Nova Tel provides telephone services mainly in rural areas of Newfoundland. The company also provides a full range of telecommunications services throughout the province.

The Company had a fairly successful year despite persistently poor economic conditions in its territory. Revenues increased slightly more than expenses and earnings of $3.0 million were about the same as the previous year.



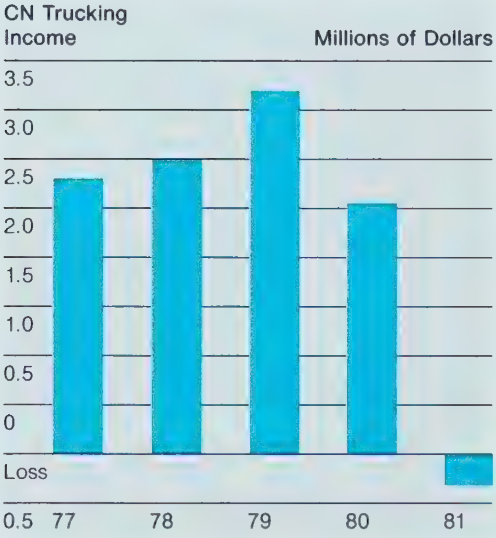
CN Trucking

A Bellechasse Transport unit negotiates the narrow streets of Quebec City. This company is part of Les Entreprises Bussières, owned by CN Trucking in partnership with the government of Quebec.

CN Trucking results reflected the economic slowdown in the second half of 1981 and significant cost increases, particularly fuel which was up by 32%. Non-operating expenses increased as well, the result of higher interest costs, loss on the sale of certain assets of Overnite Express and costs involved in the merger of the operations of Husband Transport and Overnite Express. CN Trucking lost \$0.3 million compared with a profit of \$2.1 million in 1980.

Following approval by the Canadian Transport Commission, CN Trucking completed the acquisition of Les Entreprises Bussières Ltée., in partnership with the government of Quebec. The major components of this acquisition included Bellechasse Transport Inc., Rimouski Transport Ltée., Speedway Express Ltd., and Overnite Express (1980) Inc.

In 1982 CN Trucking, together with Les Entreprises Bussières, will institute a coast-to-coast marketing service, called Route Canada, offering scheduled delivery times.



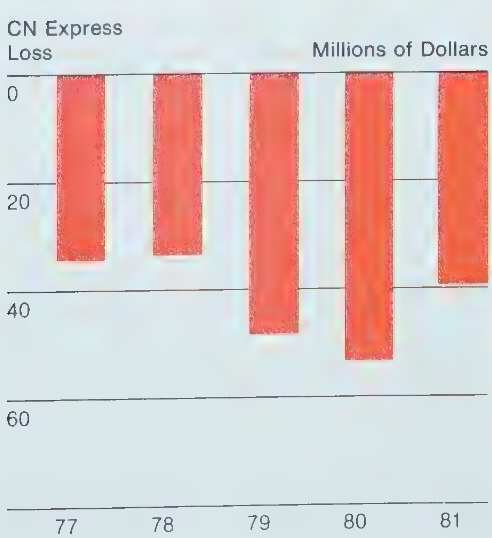
CN Express

CNX began the change-over to new identification schemes in 1981 in line with its new stance as a transporter of heavyweight shipments.

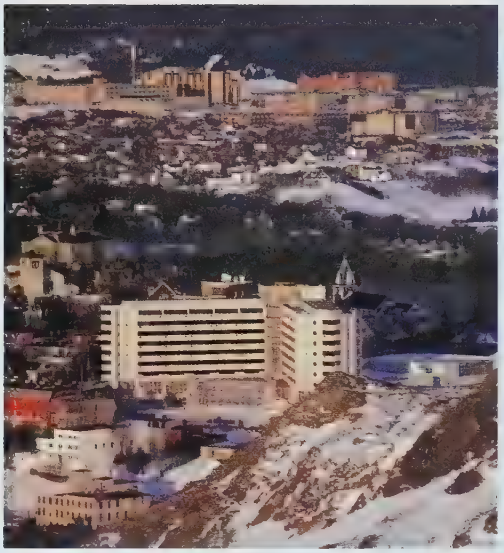
In terms of improvement over the previous year, the Express Division was one of CN's "success stories" in 1981. As a part of a vigorous program to improve productivity, CN Express withdrew from unprofitable small package services and concentrated on heavyweight, multi-piece shipments. At the same time the marketing name of the Division was changed to CNX in order to draw attention to the new direction. The Division also implemented the accounting phases of a computer-controlled information system (XTRAS) which made a substantial contribution in terms of efficiency and marketing support.

The result of these actions was a decrease in the number of shipments and in the number of pieces handled and a reduction of about $13 million in the recorded loss. This represents a reversal of the pattern of annual increases in losses which has plagued the Express Division in recent years.

Plans for the coming year include marketing concentration on heavy-weight, multi-piece shipments, completion of the XTRAS system and further deficit reduction.



The new Hotel Newfoundland takes its place on the skyline of St. John's.



Financial returns from Hotels and Tower declined in 1981 but the Division remained in a profit position and management looks forward to a year of accomplishment in 1982.

A significant event of the year was the start of construction on the new 312-room Hotel Newfoundland in St. John's. This project is a joint venture with Baine, Johnston and Company Limited of St. John's and the hotel will be managed by CN Hotels. The project represents the first major expansion undertaken by the Division in recent years and symbolizes the direction CN Hotels is taking in the 1980s.

Also indicative of the policy of seeking expansion through joint ventures are the negotiations which have been continuing for the development of a new hotel in Toronto. This hotel will be part of a proposed complex which will include an office building and a convention centre, all to be built on lands adjacent to the CN Tower.

An important activity of the year was the planning for CN Hotels to assume direct responsibility for management of The Queen Elizabeth, Place Ville Marie Restaurants and the Hotel Vancouver in 1984. These properties of CN have been managed up to now by Hilton Canada Inc.

Sale of the Hotel Nova Scotian in Halifax was part of the policy of the Division to dispose of unprofitable or marginal properties and operate a chain of profitable high-quality hotels. It was the judgment of CN Hotels management that a geographical shift of the economic centre of Halifax had left the Hotel Nova Scotian too far from the modern center of the city.

A major renovation program is underway at the Château Laurier in Ottawa. The program includes refurbishing of 460 bedrooms, with much of the original oak and mahogany furniture restored and returned to use. Cost of the renovations will be about $6.0 million.

Studies necessary for extensive structural improvements to the Hotel Macdonald in Edmonton and development of other space on the site for office/commercial use have been undertaken in conjunction with CN's Real Estate Division.

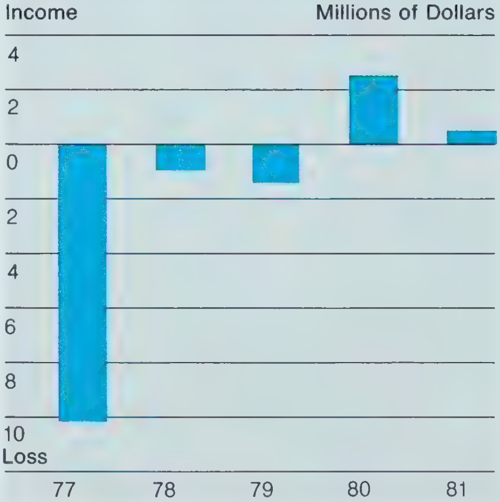
Outlook

"Cautious optimism" is the watchword for 1982. Occupancies of most Hotels are expected to remain at the same level as 1981. Current volume of business at the observation and dining facilities at the CN Tower in Toronto is also expected to be maintained. Capital expenditures will remain at about $12 million, approximately the same as in 1981, and are expected to be financed by cash generated within the Division.

Preparing for the takeover of the hotels and restaurants now managed by Hilton Canada Inc. will call for intensive planning, liaison, and marketing efforts during 1982 and 1983.

Considerable progress was made in 1981 in the development of a new identity for the hotel chain. The program, which will be further developed in 1982, includes a new in-house magazine "Hospitality", color-coordinated promotional and guest supplies and a new staff uniform program.

CN Hotels and Tower
Income



CN Marine Inc.

CN Marine Inc., which operates the principal ferry services on the East Coast under contract to the government of Canada, made a modest profit in 1981 and expects to operate with increased efficiency and more modern equipment in 1982 and subsequent years.

Traffic volumes on almost all services were slightly lower than in the previous year.

Based on planning initiated in 1981, the company will acquire additional computer capacity to develop and implement an improved financial accounting system and a new materials management system. Improved systems for traffic information, manpower, management accounting, capital assets and vessel support will be added later.

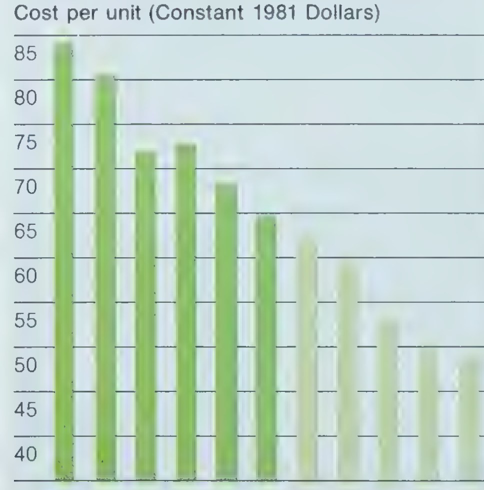
Progress continued on a fleet modernization program which includes construction of the new ferry Abegweit at Saint John, N.B. Tenders have been called for construction of a new high-speed passenger vessel for service on the south coast of Newfoundland. As well, tenders on an additional modern ferry for the Nova Scotia-Newfoundland service are being reviewed and existing vessels in the fleet have undergone an extensive refurbishing program to upgrade passenger areas.

In 1981 CN Marine established a task force to ascertain and meet the needs of handicapped travellers. Eight disabled volunteers inspected CN Marine ships and services and recommended ways to improve them and also to improve access to new facilities which are being designed. The group has agreed to act as an advisory council to the company for on-going consultation on access by the disabled to CN Marine services.

At year-end plans to improve further the cost efficiency of the East Coast ferry services were announced by the Government of Canada. More productive use of present capacity, including the elimination of some water routes which parallel highways, will result.

The new Abegweit for the Borden, P.E.I. to Cape Tormentine, N.B. service was christened at Saint John, N.B. in 1981. The streamlined funnel is shown being lowered into place.

CN Marine Inc.
Cost per unit (Constant 1981 Dollars)



CNM Inc.

New TerraTransport containers began arriving in Newfoundland in 1981 as the first stage of the shift from conventional railcars to containers.

CNM Inc. is the holding company for marine ventures other than ferry services operated under contract with the Government of Canada.

Among CNM Inc.'s holdings is Coastal Transport Ltd. which provides a ferry service to Grand Manan Island for the province of New Brunswick. Some increase in traffic on this service occurred during the year.

The Newfoundland Dockyard is managed as part of CNM Inc. Contracts worth $26 million have been awarded to modernize the yard at St. John's and increase its capacity. Completion of the work is scheduled for late 1983.

CNM Inc. holds an equity position in Halifax Industries (Holdings) Limited. A new large floating drydock is under construction as part of a projected modernization of ship repair and refit facilities at Halifax, Nova Scotia.

CNM Inc. also holds equity in Lakespan Marine Inc., a company which inaugurated trailer ship service across Lake Ontario between Canada and the United States in 1981, and in Seabase Limited, which provides shore-based services for supply vessels and drilling rigs involved in oil and gas exploration on the East Coast. Customers of Seabase include the off-shore oil industry, CN Marine's Labrador coastal operations and Federal Commerce and Navigation Ltd. serving the port of St. John's.

TerraTransport

As part of a drive to improve its cost efficiency and financial position, TerraTransport, CN's surface transportation Division in Newfoundland, has begun a marketing and operational program which looks to a shift in emphasis from conventional railcars to containers. Federal Government approval and funding were obtained in 1981 for the program which was developed after extensive investigation of strategic planning alternatives. The program is expected to improve the marketability of railway transportation in Newfoundland and to help moderate the growth in the deficits of the Division.

TerraTransport incurred a loss of $28.8 million in 1981, an increase of $1.9 million over the 1980. The workload of the Division was lower than last year but Roadcruiser traffic was up slightly.

The computer based TerraTracs and XTRAS Control systems became operational during the year and three Servocentres were established across the province. Both moves enhanced the efficiency of the Division.

TerraTransport is also seeking authority from the Canadian Transport Commission to close small stations which are no longer required for railway operations and to discontinue passenger coach service on freight trains on some branch lines.

A special labor agreement signed in 1981 will improve TerraTransport's ability to effect staff adjustments and to bring workload and manpower requirements into balance.

CN Exploration

CN Exploration Inc. was activated early in 1981 to establish a closer management focus on CN-owned mineral rights in western Canada, previously managed through the Real Estate function.
The potential of the inventory of undeveloped acreage is being evaluated with the help of technical consultants. These studies have already identified a number of areas where CN properties adjoin proven and producing hydrocarbon deposits. One area at Cactus Lake, Saskatchewan, close to the Alberta border, was developed in mid-1981, and is now producing. Other similar areas are being assessed for further developments. Situations where the value of CN holdings might be enhanced by pooling the specific acreages with those adjoining are also being examined.

Real Estate

The newly created Real Estate Division became fully operational and accountable as a profit centre in 1981. Organizational implementation was relatively smooth, with operating results better than expected. The Division earned a profit of $14.7 million, including earnings by CN Exploration of $4.1 million.

Detailed architectural plans for the Toronto Convention Centre Complex, which is to include an office tower and a hotel, were developed in 1981. Total cost of the project is estimated to be $171.9 million. The Metropolitan Toronto Convention Centre Corporation will lease and operate the convention centre, CN Hotels will operate the hotel facility and CN Real Estate will manage the office complex. Construction is expected to commence in Spring, 1982, with completion anticipated in 1984.

A joint venture agreement with Nu-West Corporation has been concluded for the redevelopment of the Hotel Macdonald site in Edmonton. Plans call for a luxury hotel (retaining the existing historic section of the Macdonald hotel) and two office towers with about 500,000 square feet of office space. Other developments are in hand for Calgary, Winnipeg, Toronto and Montreal.

Review and identification of properties which have potential for development is being continued. The priority of the Division is to increase its income base through a combination of development and property management activities, as well as to provide efficient real estate services to other divisions of the Corporation.

CANAC

During 1981, CANAC Consultants Ltd. marked the tenth anniversary of its incorporation as CN's international consulting arm and reached something of a milestone in recording its first net earnings of more than $1.0 million. CANAC produced income of $1.5 million compared to $0.8 million in 1980 and $0.6 million in 1979.

CANAC's presence in Latin America was strengthened during the year with the signing of a multi-year contract extension in Brazil and through negotiations leading to good development potential in several other Latin American countries.

In the Far East, CANAC negotiated a contract in Thailand and assisted another Canadian consultant in a port development project in India. Activities in Pakistan and Bangladesh continued.

In East Africa, CANAC secured a substantial contract in Tanzania and one in Zambia under World Bank financial sponsorship. CANAC also conducted extensive development work in other East African countries and completed an assignment in Kenya.

In West Africa work continued in Cameroon, Mali, Ivory Coast, Guinea and Ghana.

In Canada and the U.S., new contracts were acquired and others extended with major rail passenger corporations and with an agency of the U.S. Government, the United States Railway Association.

In the area of procurement and inspection services, CANAC concluded the delivery of 500 freight cars and 20 locomotives to Cameroon as well as 18 tank and 14 ballast cars, four passenger coaches and other railway related equipment to Mali.

CANAC continued to diversify its range of business activities and began marketing a patented ultrasonic weld flaw detector, advanced locomotive simulator training techniques and hardware, and management information hardware and systems.

CANAC looks forward to increased business activity in 1982 with a number of contract proposals in preparation or being negotiated.

During 1981 CANAC was represented in Mexico by Amexder S.A. de C.V. No remuneration was payable or paid to this representative.

People and Organization

Human Resources

The title of Vice-President, Personnel, was changed to Vice-President, Human Resources, during 1981 and a new appointment to the position was made.

This reflects the concept that "Human Resources" in CN is expected to be concerned with the entire employee population, the overall objectives of the company and, over and above the personnel administration processes, the development and application of policies and management practices that will motivate the work force.

The designation "Human Resources" places an emphasis on the fact that employees are considered to be a resource more important than capital and plant.

CN Employees Suggestion Plan

During the year, 505 suggestions were processed. Of these, 159 or 31.49% were adopted – a quite respectable rate by general industry standards.

Awards totalling $66,525 were paid in 1981.

In terms of benefit to the company, the Suggestion Award Program generated first year net savings of more than half a million dollars in 1981. These savings do not include benefits realized from the adoption and implementation of a number of "intangible" suggestions which cannot be measured in terms of actual dollar savings but do make an important contribution.

The vast majority of adopted suggestions continue to yield benefits for at least five years and it is estimated that the CN Suggestion Plan has generated a net financial return of six million dollars to the company over the five year period 1977 – 1981.

Pensioners' Benefits

A total of 45,151 pensioners and beneficiaries received $198.9 million in 1981 compared with 45,170 pensioners and

beneficiaries receiving $177.7 million in 1980.

Human Values

Human values and their significance in productivity improvement continue to be of major concern to Canadian National. Early in 1980, an Organization Design and Development Unit was formed within the Human Resources Department. During 1981, this unit carried out research and developed some projects designed to improve productivity and the quality of working life across the System. This activity will intensify through 1982.

Labour Relations

National labour negotiations began during the year for the renewal of collective agreements which expired on December 31, 1981. At year end negotiations were in progress with each of the five major railway bargaining groups, as well as with bargaining groups in other divisions.

During the year a special agreement was signed with various unions establishing conditions and benefits to apply to employees affected by changes in the TerraTransport division.

Negotiations were completed with the Brotherhood of Maintenance of Way employees to introduce a training program for Bridge and Building employees.

Several changes took place in union representation of employees. In addition, some union certifications were amended to reflect more adequately the divisionalized structure of the corporation.

Central Services

Organizational changes during the year included the creation of the position of Vice-President, Central Services. This position was established to provide executive direction to headquarters departments which provide internal services to CN and its Divisions. The departments include Management Services, Purchases and Materials Management, Medical & Health Services, CN Police, Linguistic Services, and Office Design and Services.

Management Services

Development of new computer system applications has been one of the principal methods used by CN to improve its long term commercial viability. Management Services operates the main computer plant and provides the technical expertise to assist other CN departments to develop and use computer systems. Systems under development and those implemented in 1981 – such as the "customer data exchange" system which permits customers to enter bill of lading information directly into CN's traffic reporting and control systems – are designed to improve performance and effect cost savings throughout the System. Management Services also worked with operating divisions as well as corporate departments in further developing the automated office and in applying advanced management techniques to the solution of strategic planning problems.

Medical Services

Areas of growing interest and concern for Medical Services were those of Industrial Hygiene, Medical Standards and the Medico-legal aspects of Human Rights. Expanded programs are being developed in these areas.

Some measure of the benefit which the company derives from the department may be gained from the fact that about 100,000 visits were made by employees to the medical clinics during 1981. In addition, a significant proportion of the time of the doctors is spent in assisting staff in the Employee Assistance Program, particularly in the areas of alcoholism and drug abuse.

Public Affairs and Advertising

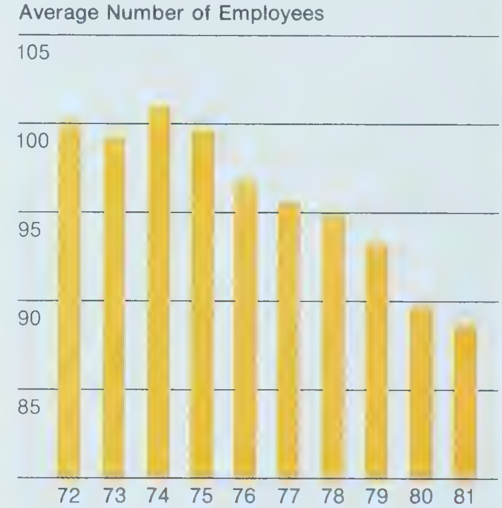
In 1981 CN adopted a new slogan "CN in Business For Canada" for its English-language television advertising.

Research had indicated that the earlier slogan "At CN keeping Canada on the go is a business as well as a responsibility" had been misinterpreted by some part of the public as meaning that CN had a responsibility to meet all public service demands regardless of cost.

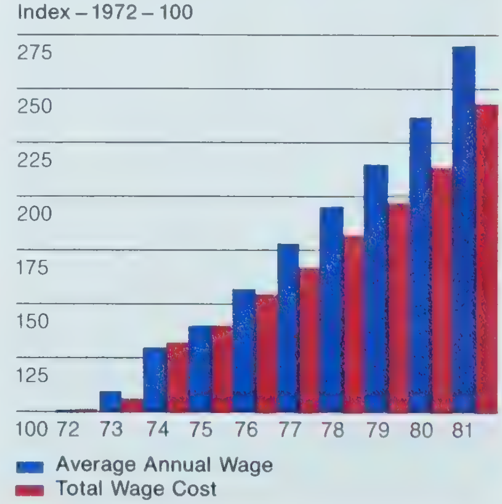
The new English slogan is designed to emphasize the role of CN as a business corporation while emphasizing also that the company's business success benefits all of Canada.

The slogan used in French-language TV commercials was also changed in 1981; from "CN – rentable pour tout le monde" to "CN – le sens des affaires". The objective, again, was to strengthen the business message.

Average Number of Employees



System Wage Cost 1972 to 1981
Index – 1972 – 100



Results of operations

The System's net income for the year 1981 was $193.2 million, as compared with $192.7 million in 1980 and $208.2 in 1979. These results include payments from the Government of Canada for certain uneconomic rail services provided in earlier years and revenues relating to a prior period under the contract with VIA Rail Canada Inc. amounting to $58.7 million in 1981, $20.5 million in 1980 and $33.9 million in 1979. The decline in the 1981 income compared with 1980, after exclusion of these payments, was in part due to the obligation to carry grain at fixed statutory rates while the cost of moving such traffic continued to increase and was also due to lower business activity, notably in the second half of the year, as a result of the recession in Canada. The depressed economic conditions have continued into the early part of 1982 and are expected to result in a significant deterioration in results for the first quarter of 1982 as compared with the same period of 1981.

In accordance with applicable legislation, the Company provided a dividend of 20% of net income to the Government of Canada. The dividend amounted to $38.6 million in 1981 compared to $38.5 million in 1980 and $41.6 million in 1979.

The results for each division, which are discussed below, include the interest expenses which amounted to $170.8 million in 1981, up $59.9 million over 1980 and $74.4 million over 1979. These increases reflect increased borrowings in both 1981 and 1980 and higher interest rates as well as reduced investment income in 1981.

CN Rail

CN Rail's income for 1981 totalled $230.4 million, compared with $251.0 million in 1980 and $226.2 million in 1979. The principal factors in the 1981 decline were losses on Western grain traffic and the economic recession discussed above as well as the increase in interest expense.

Railway operating revenues amounted to $3,053.1 million in 1981, up $405.9 million from 1980 and $705.8 million from 1979. Carload freight services revenue was the major factor in both the 1981 and 1980 improvements. In 1981, carload freight revenues rose by $271.6 million mainly because of rate increases. Traffic volume declined in nearly all commodity groups because of the general economic recession and strikes in several industries. The 1981 revenues also benefitted from increased recoveries from VIA Rail Canada Inc. for services provided in the current year and for a prior period, and higher payments from the Government of Canada both for current and prior years' subsidized operations. In 1980, carload freight services revenues increased by $231.2 million mainly from tariff increases and greater volumes of coal, sulphur and grain traffic. The remainder of the 1980 revenue improvement came from increased recoveries from VIA Rail Canada Inc.

Expenses in 1981 were $2,822.7 million, up $426.5 million from 1980 and $701.5 million from 1979. The 1981 increase was mainly attributable to inflation-related cost increases in labour rates, fuel and other material prices and interest costs. Inflation was also the principal factor in the 1980 expense rise.

Grand Trunk Corporation

Grand Trunk Corporation earned income of $40.5 million in 1981 compared with $9.1 million in 1980 and $29.6 million in 1979. Higher revenues, containment of expenses and sale of tax credits were the most significant factors in the 1981 income improvement. The decline in income in 1980 over 1979 was mainly the result of reduced traffic volumes. Rate increases and reductions in the work force tempered the effects of the reduced traffic and inflation in 1980.

Revenues amounted to $468.6 million in 1981, $338.3 million in 1980 and $312.6 million in 1979. In 1981, the revenue increase of $130.3 million included revenues of the Detroit, Toledo and Ironton Railroad Company (acquired June, 1980) and The Detroit & Toledo Shore Line Railroad Company (acquired April, 1981). Excluding such revenues, there was a revenue improvement of $61.3 million in 1981 with freight rate increases being the most significant factor, and the remainder resulting mainly from increased traffic volumes of automobiles and parts, chemicals and primary metals. In 1980, the revenue increase amounted to $25.7 million over 1979. Excluding the DTI revenues, there was an overall reduction of $18.0 million from the 1979 level. Automobile traffic was off substantially and lumber and potash traffic were also down. Rate increases partially offset the effect of the reduced traffic.

Expenses totalled $428.1 million in 1981, $329.2 million in 1980 and $283.0 million in 1979. Excluding the expenses of the DTI and DTSL, there was an increase of $33.5 million in 1981 as compared with 1980. Labour rate increases and higher fuel prices were the most significant factors in the increase. These cost increases were tempered by manpower reductions despite the higher traffic volume. In 1980, after excluding the DTI, expenses increased by $0.7 million. Savings were made in labour costs, car hire and fuel expenses as a result of the declines in traffic volume. However, the savings were insufficient to offset the effect of higher wage rates, and material prices, particularly fuel.

CN Communications

CN Communications' income in 1981 was $31.8 million, compared to $33.2 million in 1980 and $25.5 million in 1979. The $1.4 million decrease in 1981 occurred mainly because revenue growth was not sufficient to offset increased expenses, particularly for interest and depreciation. The $7.7 million improvement in 1980 over 1979 resulted mainly from a higher volume of business activity, increased rates, and productivity improvements from automation.

CN Trucking

CN Trucking had a loss in 1981 of $0.3 million compared with profits of $2.1 million in 1980 and $3.2 million in 1979. This downtrend was caused mainly by higher inflation and the general decline in economic activity. In addition, in 1981, extensive costs were incurred by one trucking company in integrating its existing operations with those of a newly-acquired company.

CN Express

CN Express' loss was $39.9 million in 1981, an improvement of $13.2 million over 1980 and $7.3 million over 1979. Revenues and expenses both declined in 1981 and 1980 as compared with 1979 as a result of planned reductions of uneconomic services and the general slowdown in the economy.

CN Hotels and Tower

CN Hotels and Tower earned income of $0.5 million in 1981 compared with $2.6 million in 1980 and a loss of $1.6 million in 1979. The 1981 income was down because of a loss on the sale of a hotel and lower occupancy rates at most of the hotels. The 1980 improvement over 1979 resulted mainly from higher room rates and an increased volume of business.

CN Marine Inc.

CN Marine Inc.'s income in 1981 was $9.3 million, up $0.6 million from 1980 and up $1.5 million from 1979. The 1981 improvement was largely the result of rate increases and productivity improvements. The increased income in 1980 compared to 1979 was principally due to higher rates and increased passenger-related vehicular traffic.

CNM Inc.

CNM Inc.'s income declined from $1.0 million in 1979 to $0.1 million in 1980 to a loss of $1.2 million in 1981. Losses on equity holdings, partially offset by a recovery in dockyard income, accounted for the 1981 deterioration. The decline in the 1980 income as compared with the 1979 income resulted from reduced dockyard income.

TerraTransport

TerraTransport's loss in 1981 was $28.8 million, $1.9 million higher than in 1980 and $4.0 million over the 1979 level. The main factors in these deteriorations were the impact of inflation, and a downtrend in traffic.

Real Estate

Income from the Real Estate Division amounted to $14.7 million in 1981 compared with $21.4 million in 1980 and $17.5 million in 1979. Fluctuation in profits on land sales was the principal factor in the variances in income. Included in this segment is the net income from CN Exploration which grew from $2.7 million in 1980 to $4.1 million in 1981 and includes oil sales in 1981 of $1.5 million.

Miscellaneous

The loss in the Miscellaneous Sector in 1981 was $61.8 million, $8.5 million worse that 1980 and $36.1 million worse than 1979. Inflationary increases in expenses and a non-recurring profit on the sale of investments in 1980 accounted for the difference between 1981 and 1980. The increased loss in 1980 over 1979 reflected mainly lower subsidies from prior years' operations.

Income Taxes

Income taxes otherwise payable with respect to 1981 in the amount of $91.1 million have been eliminated through utilization of tax benefits pertaining to prior years' losses, which reduction was accounted for as an extraordinary item. See Note 10 of Notes to Consolidated Financial Statements, which indicates that potential tax benefits are available to reduce taxable income of future years.

The Company expects that such benefits will provide reductions in income taxes in amounts covering substantially all taxes on income through 1984.

Inflation

The impact of inflation has become an increasingly important factor in the operations of the Company. In the three-year period ended December 31, 1981, the Canadian Consumer Price Index rose approximately 35%; however, the Company's cost of material increased by about 80% and its wage costs by more than 40% during the same period.

The Company has sought to control operating expenses by improving its facilities and operating efficiency. The Company has also implemented tariff increases designed to defray increased operating costs but is unable to increase certain tariffs because of governmental regulations. The most important rate restraint imposed on Canadian rail operations is legislation maintaining Western grain traffic rates at levels which result in significant losses on such operations. Certain non-rail rates, including trucking and telecommunications, are regulated. In many cases, rate increases are implemented long after cost increases have been incurred.

Inflation also has a significant impact on the requirements for capital expenditures. The rising cost of such expenditures necessitates increased borrowings at a time when inflation and other factors have resulted in record high interest rates.

The inflationary impact in the case of U.S. rail operations is similar to that in Canada with high material price inflation and wage increases having a significant effect on cost of operations.

In Canada, there is, as yet, no generally accepted method of measuring and reflecting the impact of rising prices on financial statements and the matter is complex and controversial. The Canadian Institute of Chartered Accountants has recently issued a further pro-

posal in this regard and it is expected that a pronouncement will be forthcoming in 1982. The Company is keeping abreast of this and of related developments in other countries with a view to such measurement in due course.

Liquidity and Capital Resources

The tables which follow compare the Company's net cash flow for the years 1979-1981 and show its debt ratio at the close of each of such years. Deferral of new long-term borrowings because of market conditions resulted in negative cash flow for 1980 and 1981 and necessitated reliance on short-term bank borrowings which approximated $28.6 million at December 31, 1981. The Company has arrangements with a number of Canadian and U.S. banks which provide lines of credit in excess of the Company's anticipated short-term borrowing requirements.

During 1981, the Company issued and sold U.S. $400 million of long-term debt in the United States and European markets, the proceeds of which were used principally for the retirement of long-term debt and capital expenditures. In March 1982, the Company issued and sold U.S. $150 million long-term debt in the United States and borrowed SFr. 100 million under a bank loan maturing in 1987. Subject to market conditions, the Company expects to sell additional long-term debt in the capital markets, but is unable to predict the amounts, nature and timing of such borrowings.

Cash flow components for 1979-1981 are as follows:

	1981	1980	1979
		(in millions)	
Funds Provided:			
From operations	$ 429.2	$ 411.5	$ 407.7
Issuance of long-term debt	488.0	82.4	206.5
Issuance of capital stock	6.6	26.7	104.4
Long-term investment maturing in one year	–	108.0	–
Other	44.4	37.4	38.7
	968.2	666.0	757.3
Net change in working capital items other than cash	(78.8)	135.9	42.6
Cash Provided	889.4	801.9	799.9
Less: Used for			
Additions to properties	666.5	561.0	558.3
Investments	11.7	115.0	113.9
Reduction of long-term debt	227.5	155.4	23.9
Dividend	38.6	38.5	41.6
Other	4.6	–	0.4
	948.9	869.9	738.1
Net cash flow	$ (59.5)	$ (68.0)	$ 61.8

The ratio of long-term debt (including current portion) to the sum of long-term debt and shareholder's equity at the close of the last three years was as follows:

	1981	1980	1979
Debt ratio	35.9%	35.1%	35.5%

As the cash flow data indicate, the Company has made significant capital expenditures over the last three years without an adverse impact on its debt ratio. The Company has planned capital expenditures for 1982 which approximate $900 million. In addition, the Company anticipates that capital expenditures for 1983-1984 will aggregate approximately $2.5 billion. At present the Company expects that a significant portion of these expenditures will be funded through borrowings. The extent of such expenditures and, in particular, the related borrowings will be dependent in major part upon operating results, the financial impact of possible changes in the statutory rate for Western grain and other economic factors.

Of the approximately $3.4 billion of expected capital expenditures during the 1982-1984 period, the Company estimates that about $900 million will be required for expansion of roadway property to meet forecast levels of traffic in the Western provinces. The balance is expected to be used principally for renewal of the basic plant, purchase of rolling stock and other equipment, new business needs and improvement of operating efficiency.

Consolidated Financial Statements

Consolidated Statement of Income

		Year ended December 31		
		1981	1980	1979
		(in thousands)		
CN Rail	Revenues	$3,053,139	$2,647,220	$2,347,344
	Expenses	2,822,752	2,396,208	2,121,180
	Income	230,387	251,012	226,164
Grand Trunk Corporation	Revenues	468,628	338,322	312,627
	Expenses	428,133	329,168	282,996
	Income	40,495	9,154	29,631
CN Communications	Revenues	217,641	192,335	174,084
	Expenses	185,882	159,114	148,609
	Income	31,759	33,221	25,475
CN Trucking	Revenues	99,142	80,298	75,876
	Expenses	99,403	78,165	72,696
	Income (loss)	(261)	2,133	3,180
CN Express	Revenues	105,743	126,918	139,318
	Expenses	145,639	180,050	186,510
	Loss	(39,896)	(53,132)	(47,192)
CN Hotels and Tower	Revenues	58,184	56,598	55,825
	Expenses	57,702	54,021	57,412
	Income (loss)	482	2,577	(1,587)
CN Marine Inc.	Revenues	175,475	163,268	153,967
	Expenses	166,162	154,535	146,146
	Income	9,313	8,733	7,821
CNM Inc.	Revenues	17,690	14,696	13,276
	Expenses	18,878	14,650	12,268
	Income (loss)	(1,188)	46	1,008
TerraTransport	Revenues	49,078	44,112	41,409
	Expenses	77,901	70,983	66,242
	Loss	(28,823)	(26,871)	(24,833)
Real Estate	Revenues	24,290	27,483	22,831
	Expenses	9,627	6,074	5,345
	Income	14,663	21,409	17,486
Miscellaneous	Loss	(61,781)	(53,306)	(25,699)
Income before income taxes and extraordinary item		195,150	194,976	211,454
Income taxes		93,120	91,054	98,250
Income before extraordinary item		102,030	103,922	113,204
Reduction in income taxes on application of prior years' losses		91,140	88,804	94,961
Net income		$ 193,170	$ 192,726	$ 208,165

See accompanying notes to consolidated financial statements.

Consolidated Balance Sheet

		December 31			
			1981		1980
Assets			(in thousands)		
Current Assets	Cash		$ –		$ 46,032
	Accounts receivable		451,305		416,667
	Material and supplies		436,621		378,269
	Other current assets		175,022		176,891
			1,062,948		1,017,859
Insurance Fund			34,531		29,539
Investments			94,046		93,380
Properties			4,838,970		4,398,974
Other Assets and Deferred Charges			109,672		105,461
			$6,140,167		$5,645,213
Liabilities					
Current Liabilities	Bank loans and other indebtedness		$ 63,721		$ 50,288
	Accounts payable		595,134		501,773
	Accrued charges		224,540		192,257
	Current portion of long-term debt		35,814		149,846
	Other current liabilities		151,821		151,087
			1,071,030		1,045,251
Provision for Insurance			34,531		29,539
Other Liabilities and Deferred Credits			222,690		180,017
Long-Term Debt			1,701,531		1,441,171
Minority Interest in Subsidiary Companies			4,345		4,345
Shareholder's Equity	Capital stock of Canadian National Railway Company; 6,275,302 (1980 - 6,262,074) common shares of no par value authorized, issued and outstanding	$2,482,125		$2,475,511	
	Retained earnings	623,915	3,106,040	469,379	2,944,890
			$6,140,167		$5,645,213

On behalf of the Board: J.A. Dextraze, Director R.A. Bandeen, Director

See accompanying notes to consolidated financial statements

Consolidated Statement of Retained Earnings

	Year ended December 31		
	1981	1980	1979
	(in thousands)		
Balance, beginning of year	$469,379	$315,198	$148,666
Net income for the year	193,170	192,726	208,165
	662,549	507,924	356,831
Dividend	38,634	38,545	41,633
Balance, end of year	$623,915	$469,379	$315,198

See accompanying notes to consolidated financial statements.

Consolidated Statement of Changes in Financial Position

		1981	1980	1979
		Year ended December 31 (in thousands)		
	Working Capital (Deficiency), beginning of year	$ (27,392)	$ 176,465	$ 157,362
Funds Provided	Net Income for the year	193,170	192,726	208,165
	Add/(deduct) items not involving the current provision or use of funds			
	– depreciation	224,224	200,505	187,774
	– share of net (income) loss retained by investees accounted for by equity method	3,388	2,967	(1,744)
	– amortization of discount on long-term debt	465	767	778
	– other	7,950	14,547	12,696
	Funds from operations	429,197	411,512	407,669
	Net proceeds from disposal of assets and investment	32,610	27,248	27,553
	Issuance of long-term debt	487,953	82,388	206,525
	Issuance of capital stock	6,614	26,676	104,361
	Repayments of advances and balance of sale of assets	8,835	8,753	11,180
	Working capital of subsidiary acquired	2,961	1,429	–
	Long-term investment maturing within one year	–	108,000	–
	Total Funds Provided	968,170	666,006	757,288
Funds Used	Additions to properties	666,518	561,014	558,285
	Investments			
	– acquisition of subsidiaries	2,266	48,928	–
	– purchase of acquired subsidiary bonds	–	14,700	–
	– other	9,404	51,326	113,936
	Dividend	38,634	38,545	41,633
	Reduction of long-term debt	227,478	155,350	23,894
	Discount on issuance of debentures	4,560	–	437
	Total Funds Used	948,860	869,863	738,185
Increase (Decrease) in Working Capital		19,310	(203,857)	19,103
	Working Capital (Deficiency), end of year	$ (8,082)	$ (27,392)	$ 176,465

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note 1: Summary of Significant Accounting Policies

Introduction

All references in these Notes to the "Company" refer to Canadian National Railway Company which is wholly-owned by the Government of Canada and, unless the context otherwise requires, its consolidated subsidiaries, and all references to the "System" mean Canadian National Railway Company and its consolidated subsidiaries together with the lines of railway, marine, telecommunications and other property entrusted by the Government of Canada to the Company for management and operation.

a) Principles of Consolidation

The consolidated financial statements include the accounts of all subsidiaries and the Company's share of the assets, liabilities, revenues and expenses of CNCP Telecommunications which is accounted for by the proportionate consolidation method; CN's share in the activities of CNCP Telecommunications represents slightly less than two-thirds of the activities of CN Communications. Also, consistent with the legislation governing the System, the accounts of the Canadian Government Railways entrusted to the Company by the Government of Canada are included in the consolidated financial statements.

Investments in jointly-operated companies in which the Company has less than a majority interest are accounted for by the equity method where appropriate.

b) Reporting by Division

In presenting the results by division, charges for services performed by one division for another, which are made generally at market value, have not been eliminated. Consolidated net income is not affected by this practice.

c) Material and Supplies

The inventory is valued at laid down cost based on weighted average cost for ties and rails, latest invoice price for fuel and new materials in stores, and at estimated utility or sales value for usable second hand, obsolete and scrap materials.

d) Insurance Fund

The System is self-insured for various risks, maintaining a separately invested fund. The provision for insurance represents the estimated amount of self-insured losses to be adjusted.

e) Properties

Properties are carried at cost, which, in the case of properties brought into the System on January 1, 1923, is the aggregate of the values then appearing in the books of the railways now comprised in the System, less a write-down of $262.8 million at the time of capital revision in 1937.

Accounting for railway and telecommunications properties is carried out in accordance with rules issued by the Canadian Transport Commission and the Canadian Radio-television and Telecommunications Commission respectively (Canadian properties), and the Interstate Commerce Commission (United States properties), except, in the case of United States properties, for the application of depreciation accounting to ties, rails, other track material and ballast. Major additions and replacements generally are capitalized with the exception of labour costs relating to track material replacement and interest costs which are charged to expense.

The cost of depreciable assets retired or disposed of, less salvage, is charged to accumulated depreciation, in accordance with the group plan of depreciation except for CN Trucking and CN Hotels and Tower divisions which follow the unit plan whereby gains or losses are taken into income as they occur.

f) Depreciation

Depreciation is calculated at rates sufficient to write off properties over their estimated useful lives, generally on a straight-line basis. For railway and telecommunications properties, certain rates are authorized by the Canadian Transport Commission, the Canadian Radio-television and Telecommunications Commission and the Interstate Commerce Commission. The rates for significant classes of assets are as follows:

	Annual Rate
Ties	3.25%
Rails	1.15%
Other track material	1.90%
Ballast	4.00%
Road locomotives	4.60%
Freight cars	2.97%
Commercial communication systems	5.03%

Hotel properties are depreciated at annual rates of 2% to 10% and vessels at 5%.

g) Transportation Revenues

Transportation revenues are generally recognized on completion of movements, with interline movements being treated as complete when the shipment is turned over to the connecting carrier. Costs associated with uncompleted movements are generally deferred.

h) Pensions

Current service costs are charged to operations, and funded, as they accrue.

Prior service costs are charged to operations and funded by annual payments covering principal and interest over varying periods to 2006 (2015 in the case of U.S. Plans).

i) Foreign Exchange

Assets and liabilities in foreign currencies have been translated into Canadian dollars at current rates except for investments, properties and long-term debt for which historical rates have been used. Income is charged or credited with all exchange differences. Income and expenses of foreign subsidiaries have been translated at average rates during the year except for depreciation provisions which are on the same basis as the related properties.

Note 2: Investments

	Percentage of Voting Interest	December 31 1981	1980
		(in thousands)	
Jointly-operated companies, on equity method			
Chicago & Western Indiana Railroad Company	20%	$ 7,191	$ 7,122
The Detroit & Toledo Shore Line Railroad Company[1]	–	–	6,080
Les Entreprises Bussières Ltée	50%	3,389	–
The Toronto Terminals Railway Company	50%	10,682	10,882
Other		4,135	4,175
		25,397	28,259
Other companies and investments, at cost			
The Belt Railway Company of Chicago	7.69%	616	603
Eurocanadian Shipholdings Limited	18%	61,514	61,514
Intercast S.A.	18%	100	100
Telesat Canada	3.75%	2,250	2,250
Other		4,169	654
		68,649	65,121
Total		$94,046	$93,380

[1] Effective April 1, 1981, Grand Trunk Western Railroad Company purchased for approximately $2.3 million the remaining 50% equity interest in The Detroit & Toledo Shore Line Railroad Company which was merged with Grand Trunk Western Railroad Company on October 1, 1981.

Note 3: Properties

	December 31, 1981			December 31, 1980		
	Cost	Accumulated Depreciation	Net	Cost	Accumulated Depreciation	Net
	(in thousands)			(in thousands)		
Railway						
Canadian Lines[1]	$6,332,759	$2,507,777	$3,824,982	$5,888,608	$2,403,001	$3,485,607
Grand Trunk Corporation	567,052	143,124	423,928	505,974	135,242	370,732
	6,899,811	2,650,901	4,248,910	6,394,582	2,538,243	3,856,339
CN Communications	603,218	215,647	387,571	553,693	192,439	361,254
CN Trucking	66,454	33,105	33,349	58,957	28,388	30,569
CN Hotels and Tower	189,183	61,763	127,420	189,589	62,404	127,185
Other	55,740	14,020	41,720	33,239	9,612	23,627
	914,595	324,535	590,060	835,478	292,843	542,635
	$7,814,406	$2,975,436	$4,838,970	$7,230,060	$2,831,086	$4,398,974
Amounts included above with respect to Canadian Government Railways entrusted to the Company by the Government of Canada	$ 860,917	$ 483,508	$ 377,409	$ 864,455	$ 460,051	$ 404,404

[1]Includes CN Rail, CN Express, CN Marine, TerraTransport and Miscellaneous properties.

Note 4: Long-Term Debt

		Maturity	Currency in which payable	December 31 1981	1980
			(in thousands)	(in thousands)	
Bonds, Debentures and Notes	Canadian National 4% 23 Year Bonds (a)	Feb. 1, 1981	Canadian	$ –	$ 300,000
	Detroit & Toledo Shore Line 1st Mortgage Bonds	Dec. 1, 1982	U.S. $ 2,041	2,434	–
	Canadian National 5-3/4% 25 Year Bonds (a, b)	Jan. 1, 1985	Canadian	68,242	70,442
	Canadian National 8-3/8% 10 Year Bonds	Nov. 15, 1986	U.S. $ 85,000	83,232	83,232
	Canadian National 8-7/8% 10 Year Bonds (b)	Mar. 1, 1987	Canadian	51,185	51,950
	Canadian National 5% 27 Year Bonds (a, b)	Oct. 1, 1987	Canadian	107,141	110,782
	Canadian National 14-5/8% 10 Year Notes	Dec. 1, 1991	U.S. $100,000	117,817	–
	Canadian National 9-1/4% 20 Year Sinking Fund Debentures	Mar. 15, 1998	U.S. $120,000	133,533	133,533
	Canadian National 8-3/8% 25 Year Sinking Fund Debentures	July 1, 2002	U.S. $ 90,000	95,342	105,935
	Canadian National 9.7% 25 Year Sinking Fund Debentures	July 15, 2004	U.S. $150,000	174,940	174,940
	Canadian National 14% 25 Year Sinking Fund Debentures	Jan. 15, 2006	U.S. $150,000	178,783	–
	Canadian National 15% 25 Year Sinking Fund Debentures	June 1, 2006	U.S. $150,000	181,238	–
	Buffalo and Lake Huron 5-1/2% 1st Mortgage Bonds	Perpetual	Sterling	795	795
	Buffalo and Lake Huron 5-1/2% 2nd Mortgage Bonds	Perpetual	Sterling	1,228	1,228
	Total Bonds, Debentures and Notes			1,195,910	1,032,837
Government of Canada Loan and Advances (c)	Government of Canada consolidated loan (d)		Canadian	235,695	241,919
	Canadian Government Railways advances for working capital		Canadian	14,108	14,970
	Total Government of Canada Loan and Advances			249,803	256,889
Other	Amounts owing under equipment purchase agreements (e)		U.S.	227,845	234,129
	Bank loan 6-3/4% (f)		Swiss Francs	64,474	64,474
	Promissory note 9-5/8% (g)		Canadian	2,189	2,400
	Total Other			294,508	301,003
				1,740,221	1, 590,729
	Less:				
	Unamortized discount on long-term debt			5,947	1,850
	Current portion of long-term debt, at historical exchange rates			32,743	147,708
				38,690	149,558
	Long-Term Debt			$1,701,531	$1,441,171

Note 4: Long-Term Debt (Con'd.)

a) Guaranteed by the Government of Canada.

b) These bonds are subject to repurchase arrangements.

c) Weighted average interest rate on Government of Canada loan and advances outstanding at December 31, 1981 and 1980, was approximately 8.2% per annum.

d) The Government of Canada consolidated loan bears interest at 8-3/4% per annum and is payable in equal semi-annual payments of $13.63 million covering principal and interest to June 30, 1998.

e) Secured by rolling stock and payable by semi-annual or quarterly instalments over various periods to 1995 at interest rates ranging from 8% to 17-3/4%. As at December 31, 1981, the principal amounts are payable as U.S. $217.7 million (December 31, 1980 – U.S. $224.4 million).

f) Principal of Swiss Francs 100.0 million repayable on April 9, 1985, or earlier at the Company's option.

g) Repayable by semi-annual instalments of $218,503, including principal and interest, to August 1, 1988.

h) Principal repayments, including sinking fund repayments and repurchase arrangements, on debt outstanding at December 31, 1981, are as follows:

	(in thousands)
Year ending December 31:	
1982	$ 40,898
1983	40,592
1984	49,996
1985	180,122
1986	124,438
1987 – 1991	544,070
1992 – 1996	347,596
1997 – 2001	251,225
2002 – 2006	145,403

i) If the year-end exchange rate had been used in translating long-term debt payable in foreign currencies, the long-term debt would have been increased by $75.2 million (1980 – $80.8 million).

Note 5: Shareholder's Equity

a) Capital Stock

During the year, 13,228 shares (1980 – 53,352) of the no par value common stock of the Company were issued to the Government of Canada at a value of $6,614,000 (1980 – $26,676,000) as part of an arrangement whereby the Government shall purchase shares in the capital stock of the Company having a value in aggregate of up to $143,100,000 as a contribution to the cost of CN Marine's capital projects. The aggregate value of shares issued to date under this arrangement is $33,290,000.

b) Retained Earnings

Under its governing legislation, the Company is required to pay to the Receiver General for Canada a dividend equal to 20% of net income for the year or such greater percentage as the Governor in Council may direct. Accordingly, a dividend representing 20% of the net income for the year, has been accrued and is included in Other current liabilities.

Note 6: Major Commitments

a) Leases

(i) The Company's lease commitments as at December 31, 1981, of which the significant portion is in respect of railway rolling stock, are as follows:

	Non-Cancellable Leases	
	Capital Leases	Operating Leases
	(in thousands)	
Year ending December 31:		
1982	$ 43,065	$ 46,936
1983	42,461	45,074
1984	42,418	37,423
1985	43,301	36,082
1986	38,834	35,278
1987 – 1991	116,510	119,532
1992 – 1996	9,382	44,151
1997 – 2001	3,213	11,823
thereafter	853	–
Total minimum lease payments	340,037	$376,299
Less amount representing imputed interest	109,160	
Present value of net minimum lease payments under capital leases	$230,877	

Many of the leases provide renewal options and an option to purchase the property at fair market value at the end of the lease term.

(ii) Rental expenses under all lease arrangements were:

	Year ended December 31		
	1981	1980	1979
	(in thousands)		
Total expenses	$178,914	$146,685	$149,472
Expenses under capital leases	$ 43,276	$ 46,852	$ 43,510

Leases entered into in 1981 which are of a capital nature are insignificant.

Note 6: Major Commitments (Cont'd.)

a) Leases (Cont'd.)

(iii) Net reduction in income and increases in assets and liabilities in the consolidated financial statements, which would have arisen if leases satisfying the criteria of capital leases had been capitalized, are as follows:

	Year ended December 31		
	1981	**1980**	**1979**
		(in thousands)	
Net reduction in income	$ 540	$ 761	$ 5,219
Increase in Assets			
Properties			
Leased properties under capital leases	$301,397	$303,937	$301,219
Less accumulated amortization	131,487	109,535	86,632
	$169,910	$194,402	$214,587
Increases in Liabilities			
Current Liabilities			
Present value of obligations under capital leases	$ 22,188	$ 23,105	$ 20,047
Non-Current Liabilities			
Present value of obligations under capital leases	$230,877	$268,534	$271,044
Less current portion	22,188	23,105	20,047
	$208,689	$245,429	$250,997

b) Other

The Company has a commitment at December 31, 1981, to purchase rail from a major Canadian steel producer over the period of the next thirty-one months at an aggregate cost of $115.5 million. In addition, there are commitments for capital expenditures of $102.1 million for railway ties and $36.7 million for rolling stock.

Note 7: Subsidies
Revenues include the following subsidies:

	Year ended December 31		
	1981	1980	1979
		(in thousands)	
Government of Canada			
a. Payments under the Railway Act paid under authority of that Act and the related Appropriation Act in respect of certain uneconomic operations, services and prescribed rates which railways are required by the Railway Act to maintain	$162,018	$ 97,592	$135,216
b. Maritime Freight Rates Act and Atlantic Region Freight Assistance Act subsidies	17,341	17,328	18,574
c. Other	5,718	5,532	3,100
Other	2,623	–	–
	$187,700	$120,452	$156,890

Note 8: Pensions

The company has retirement benefit plans covering substantially all its employees under which they are entitled to benefits at retirement age, based on compensation and length of service. Annual pension costs were as follows:

	Year ended December 31		
	1981	1980	1979
		(in thousands)	
	$182,570	$196,712	$200,749

The total amount of past service costs remaining to be charged to operations at December 31, 1981, based on the latest actuarial valuation as at December 31, 1980 (previous years based on December 31, 1977 actuarial valuation), adjusted for subsequent changes, aggregate:

	At December 31		
	1981	1980	1979
		(in thousands)	
Canadian plans	$1,445,213	$1,117,110	$1,160,994
U.S. plans	28,669	23,566	18,411
	$1,473,882	$1,140,676	$1,179,405

This amount is being charged to operations in annual amounts, including principal and interest, as follows:

	Annual Cost (in thousands)		Annual Cost (in thousands)
1982	$111,814	1996	$135,352
1983	117,961	1997	95,487
1984	121,831	1998	100,678
1985	131,434	1999	100,164
1986	138,693	2000	111,969
1987	123,620	2001	178,070
1988	130,477	2002	59,203
1989	137,722	2003	62,405
1990	145,298	2004	65,781
1991	150,701	2005	69,353
1992	137,039	2006	72,995
1993	117,099	2007-2008	802
1994	117,836	2009	1,097
1995	124,469	2010-2015	1,185

In 1981, funding exceeded the charge to operations by $4.3 million. In 1980 and 1979, charges to operations exceeded funding by $9.3 million and $13.1 million respectively. The cumulative excess of charges to operations over funding requirements, amounting to $60.1 million (1980 – $64.4 million), is included in Other Liabilities and Deferred Credits.

The actuarially-computed value of vested benefits at December 31, 1980, the date of the latest actuarial valuation, exceeded the total of the pension funds at that date by $165.1 million.

Note 9: Miscellaneous Loss

Miscellaneous loss consists of the following:

	Year ended December 31		
	1981	1980	1979
	(in thousands)		
Miscellaneous revenues	$ 16,811	$ 14,399	$ 45,088
Interest			
Total interest on long-term debt	158,192	125,284	111,034
Interest on short-term borrowings	14,946	1,017	118
Interest on investments	(2,307)	(15,376)	(14,793)
Total interest (net)	170,831	110,925	96,359
Interest assigned to divisions	(168,398)	(109,325)	(92,111)
	2,433	1,600	4,248
Other expense (net)[1]	76,159	66,105	66,539
Total expenses	78,592	67,705	70,787
Total miscellaneous loss	**$ 61,781**	**$ 53,306**	**$ 25,699**

[1]Other expense (net) consists of general corporate income and expenses.

Note 10: Income Taxes

At December 31, 1981, there is a loss carry-forward for tax purposes of $110 million which has not been recognized in the financial statements. The tax benefits pertaining to this loss carry-forward are available until December 31, 1982.

In addition, the Company has timing differences of approximately $730 million which are available to reduce taxable income of future years. Of that amount, $555 million is due to the excess of the undepreciated capital cost for income tax purposes over the net book value of depreciable assets. Investment tax credits of about $19 million, $28 million and $33 million are also available to reduce future income taxes otherwise payable until December 31, 1984, 1985 and 1986 respectively.

The Company's effective tax rate in 1981 was 3.1% lower than the normal 50.8% due principally to the exclusion from taxable income of the non-taxable portion of capital gains.

Note 11: Segmented Information

a) Geographic Areas

Virtually all of the System's operations and assets are within Canada with the exception of Grand Trunk Corporation which operates in the United States.

b) International Traffic

In addition to the revenue generated by Grand Trunk Corporation, the System derives revenue from traffic originating or terminating on railroads in the United States. In 1981, such revenues approximated $607 million (1980 – $579 million, 1979 – $524 million).

c) Identifiable Assets by Division

Note 11: Segmented information (Cont'd)

	December 31 1981	1980	1979
	(in thousands)		
CN Rail	$4,361,459	$3,957,994	$3,538,760
Grand Trunk Corporation	619,742	546,902	459,542
CN Communications	452,221	408,940	392,501
CN Trucking	62,618	59,040	53,161
CN Express	61,388	69,078	70,840
CN Hotels and Tower	141,748	143,289	141,337
CN Marine	181,707	167,731	122,953
TerraTransport	67,176	62,338	59,142
Real Estate	32,588	–	–
Miscellaneous	159,520	229,901	304,895
Total assets per Consolidated Balance Sheet	$6,140,167	$5,645,213	$5,143,131

Assets pertaining to the Real Estate Division were not separately identified in years prior to 1981. Those for CN Marine Inc. and CNM Inc. have been grouped under CN Marine.

d) Capital Expenditures and Depreciation by Division

	Capital Expenditures[1] Year ended December 31			Depreciation Year ended December 31		
	1981	1980	1979	1981	1980	1979
	(in thousands)			(in thousands)		
CN Rail	$511,085	$408,119	$313,202	$151,398	$134,690	$128,003
Grand Trunk Corporation	39,493	42,311	62,700	11,952	14,028	11,424
CN Communications	58,838	33,360	44,409	31,696	23,921	22,416
CN Trucking	8,765	8,900	6,486	5,830	5,596	5,170
CN Express	1,118	4,101	6,215	4,286	4,569	4,757
CN Hotels and Tower	10,143	6,594	7,035	5,753	5,655	5,374
CN Marine[2]	20,559	49,857	107,326	8,466	8,251	7,375
TerraTransport	7,228	4,249	5,062	2,392	2,603	2,394
Real Estate[2]	60	–	–	365	–	–
Miscellaneous	9,229	3,523	5,850	2,086	1,192	861
	$666,518	$561,014	$558,285	$224,224	$200,505	$187,774

[1]Represents additions to property, plant and equipment.

[2]Amounts for capital expenditures and depreciation pertaining to the Real Estate Division were not separately identified in years prior to 1981. Those for CN Marine Inc. and CNM Inc. have been grouped under CN Marine.

Note 12: Other Matters

a) The Company carries on ordinary business transactions with various entities controlled by the Government of Canada on the same terms and conditions as current transactions with unrelated parties.

In addition, the Company provides, under contractual arrangements, rail transportation and maintenance and marine services to the Government of Canada and to entities controlled by the latter. The revenue derived from such services rendered in 1981 aggregated $483.7 million (1980 – $409.7 million, 1979 – $315.1 million) and the amounts receivable therefrom at December 31, 1981, amount to $11.5 million ($0.2 million at December 31, 1980).

b) Commencing in 1977, the Government of Canada has agreed to pay to the Company, by way of capital grants not exceeding $292.8 million, certain amounts with respect to expenditures incurred in carrying out rehabilitation programs for branch lines in Western Canada. Total payments received up to December 31, 1981, amounted to $187.3 million of which $51.1 million was received in 1981 (1980 – $42.6 million).

Note 12: Other Matters (Cont'd)

c) Commencing in 1981, the Government of Canada has agreed to pay during its 1981-82 fiscal period an amount not exceeding $14 million to the Company to conduct a program of testing and evaluation of railway operations in Newfoundland and to reimburse CN for certain wage and wage-related costs incurred by CN at the request of the Government during the testing and evaluation period. Total billings in 1981 amounted to $8.6 million and the amounts receivable therefrom at December 31, 1981 amount to $0.9 million.

Note 13: Reclassification of Comparative Figures

During 1981, changes were made to improve the classification of certain items and for comparative purposes the 1980 and 1979 figures have been reclassified.

Note 14: Subsequent Events

a) Certain recent developments raise the possibility of a decline in the value of a portfolio investment which is stated at a cost of $61.6 million. The amount of this contingent loss, if any, cannot be estimated at this time and no provision therefor has been made in the accounts. If such a loss were to materialize, it would be accounted for as an extraordinary charge against earnings.

b) On February 17, 1982, the Company entered into a commitment with a Swiss bank to borrow SFr. 100 million for a term of 5 years at an interest rate of 7 ¾%.
It is anticipated that the proceeds from this loan will be available on March 9, 1982; such proceeds will be used for general corporate purposes.

c) On February 25, 1982, the Company entered into an Underwriting Agreement relating to the issue and sale of U.S. $150 million principal amount of 16 ¼% Sinking Fund Debentures Due 2007 to be sold in the U.S. public market, with closing scheduled for March 10, 1982. The proceeds from the debentures will be used for general corporate purposes.

Charette, Fortier, Hawey & Cie

Touche Ross & Co.

AUDITORS' REPORT

To The Honourable The Minister of Transport
Ottawa, Canada

We have examined the consolidated balance sheet of the Canadian National Railway System as at December 31, 1981 and 1980 and the consolidated statements of income, retained earnings and changes in financial position for the two years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the System as at December 31, 1981 and 1980 and the results of its operations and the changes in its financial position for the two years then ended in accordance with generally accepted accounting principles consistently applied.

Also, in our opinion, proper books of account have been kept and the transactions that have come to our notice have been within the powers of the System.

The consolidated financial statements of the System for the year ended December 31, 1979 were reported upon by another firm of chartered accountants.

Touche Ross & Co.

Montreal, Canada
March 1, 1982

Chartered Accountants

1, Place Ville-Marie, Montréal, Qué., Canada H3B 2A2 - (514) 861-8531

Pension Trust Funds - 1959 and 1935 Pension Plans - Consolidated Statement of Financial Position as at December 31

		1981	1980
		(in thousands)	
Investments	Bonds - quoted market value 1981 - $807,806; 1980 - $687,372	$ 957,206	$ 799,765
	Mortgages and loans - secured by real estate	334,072	341,256
	Real estate	83,642	75,542
	Oil and gas properties	53,500	53,500
	Equities – quoted market value 1981 – $1,148,109; 1980 – $1,217,573	1,035,646	900,435
	Short-term investments	268,804	197,795
		2,732,870	2,368,293
	Cash in banks	199	557
	Accounts receivable – Canadian National Railways	5,394	6,574
	Accrued interest and other assets	14,889	44,338
		2,753,352	2,419,762
Amount to be funded	Amount to be funded by the Company in accordance with the Pension Benefits Standards Act by periodic payments to December 31, 2006		
	Balance, beginning of year	1,170,856	1,212,598
	Add increases during year	367,756	–
	Deduct – Principal payments	(7,842)	(41,742)
	– Unfunded actuarial liability applicable to VIA Rail Canada Inc. and CNCP Telecommunications pension plans	(31,780)	–
	Balance, end of year	1,498,990	1,170,856
		$4,252,342	$3,590,618

See accompanying notes to Consolidated Statement of Financial Position

Auditors' Report

To The Honourable The Minister of Transport,
Ottawa, Canada

We have examined the consolidated statement of financial position of the Pension Trust Funds – 1959 and 1935 Pension Plans of Canadian National Railways as at December 31, 1981. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances. The actuarial liability for pensions is the subject of a separate certificate of independent actuaries which accompanies the consolidated statement of financial position, the last actuarial valuation having been made as of December 31, 1980.

In our opinion, based on our examination and the actuarial certificate, this consolidated financial statement presents fairly the financial position of the Pension Trust Funds as at December 31, 1981 and the results of their operations for the year then ended in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Also, in our opinion, proper books of account have been kept and the transactions that have come under our notice have been within the powers of the Trustee.

The consolidated financial statement of the Pension Trust Funds as at December 31, 1980 was reported upon by another firm of chartered accountants.

Mallette, Benoit, Boulanger,
Rondeau & Associés.
Chartered Accountants,
Montreal, Canada.
March 1, 1982.

Pension Trust Funds – 1959 and 1935 Pension Plans – Consolidated Statement of Financial Position as at December 31

		1981	1980
		(in thousands)	
Actuarial Liability For Pensions	**Balance, beginning of year**	**$3,590,618**	**$3,286,086**
Additions during year	Increases in actuarial liability for pensions resulting from		
	– Actuarial valuation as at December 31, 1980	325,253	–
	– Increases in pensions of existing pensioners	39,141	–
	– Pension Plan amendments	3,362	–
		367,756	–
	Contributions by employees on account of		
	– Current service	79,960	70,282
	– Prior years' service	6,713	8,658
		86,673	78,940
	Contributions by the Company including principal payments and lump sum payments to existing pensioners of $5,641 (1980 – $2,392)	181,717	185,335
	Net earnings on investments	329,040	264,587
		597,430	528,862
		4,555,804	3,814,948
Deductions during year	Pensions paid	190,624	171,822
	Refunds on termination of service	10,406	9,358
	Principal payments applied to unfunded actuarial liability	7,842	41,742
	Reduction in actuarial liability for pensions on transfer of employees to VIA Rail Canada Inc. and CNCP Telecommunications	94,590	1,408
		303,462	224,330
	Balance, end of year	**$4,252,342**	$3,590,618

On behalf of the board: J.A. Dextraze, Director, R.A. Bandeen, Director

Actuarial Certificate

To the Trustee
Canadian National Railways Pension Trust Funds

This is to certify that the actuarial liability for pensions shown in the consolidated statement of financial position of the Pension Trust Funds – 1959 and 1935 Pension Plans of Canadian National Railways as at December 31, 1981, amounting to $4,252,342,000, in my opinion represents adequate provision for the accumulated actuarial liabilities for pensions then approved and in force, pensions awaiting approval and pensions accrued to the above date in respect of employees then in service under the 1959 and 1935 Pension Plans.

Geoffrey B. White
Fellow of the Canadian Institute of Actuaries.

William M. Mercer Limited.
Montreal, February 26, 1982.

Notes to Pension Trust Funds Consolidated Statement of Financial Position

1. Summary of Significant Accounting Policies

Plans included in Statement

The Pension Trust Funds Consolidated Statement of Financial Position includes the actuarial liability for pensions with respect to the 1959 and 1935 Pension Plans of Canadian National Railways and the related investments and unfunded actuarial liability.

Consolidation of Subsidiary Companies

The Pension Trust Funds have invested in a number of wholly-owned subsidiary companies. The accounts of these subsidiary companies are consolidated with the accounts of the Pension Trust Funds.

Investment Valuation

a) Bonds are carried at their amortized cost, plus deferred amounts arising from exchanges made to improve yields which are written-off over the remaining life of the bonds sold;

b) Mortgages and loans are carried at outstanding principal balances;

c) Real estate consists of land and buildings. Land is carried at the lower of cost and net realizable value less encumbrances, and buildings at the lower of cost and net realizable value less encumbrances and accumulated depreciation;

d) Oil and gas properties, which are managed by Dome Petroleum Limited (Dome), are carried at cost. No depletion of the properties is provided for as Dome has given a guarantee, effective until January 5, 1999, that it will, at the option of the Funds, purchase the properties for a consideration equal to their cost;

e) Equities and short-term investments are carried at cost.

The quoted market value of investments in bonds and equities is based on the closing market quotations as of December 31.

Determination of Funding Payments

The funding payments are determined in accordance with the accrued benefit actuarial cost method.

The principal assumptions underlying the actuarial computations adopted by the Plans' actuary have been developed from the actual experience of the Plans in regard to the members' mortality, disability, retirement, termination of employment, and merit and periodic increases in earnings.

For purposes of the actuarial computations, the Pension Trust Funds are assumed to have a long-term rate of return of 7% per annum on investments and future increases in members' earnings have been projected using economic assumptions consistent with that projection.

The funding payments, including liquidation of the unfunded actuarial liability, meet the requirements of the Pension Benefits Standards Act and regulations thereunder. Consistent with the regulations, the Company is funding its unfunded actuarial liabilities, by annual payments, over varying periods to 2006.

Accounting for Contributions

Contributions from employees are recorded in the period that the Company makes payroll deductions.

The recording of contributions by the Company is based upon amounts required to be funded with respect to accrued actuarial liabilities and the Company's current service liability.

Income Determination

Dividend income is recorded as of the ex-dividend date. Income from other investments is recorded as earned on an accrual basis.

Gain or loss on sales of equities is based on the average cost.

Foreign Exchange

Investments denominated in foreign currencies other than short-term investments are translated at historical rates of exchange. Short-term investments and the quoted market value of investments denominated in foreign currencies are translated at current rates. Foreign dividends and interest income are translated at the rates prevailing when received.

2. Commitments

Outstanding commitments to purchase mortgages and real estate investments amounted to $137,860,000 at December 31, 1981.

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